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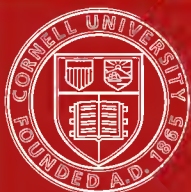
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A TREATISE ON THE
FEDERAL CORPORATION
TAX LAW OF 1909

A TREATISE
ON THE
FEDERAL
CORPORATION TAX LAW
OF 1909

TOGETHER WITH APPENDICES
CONTAINING THE ACT OF CONGRESS AND TREASURY
REGULATIONS WITH ANNOTATIONS AND
EXPLANATIONS AND FORMS
OF RETURNS

By
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PREFACE

THE publication of a commentary upon the new federal tax on corporations, companies and associations needs no apology. Upon a matter of such importance as this new tax law, corporations should certainly know their rights, — even those which they may not, knowing, dare maintain. All business corporations throughout the country will be called upon within the next few weeks to make returns under this statute; and in order to do so intelligently and without risk to themselves, they and their counsel must ascertain their rights and liabilities much more thoroughly than can be done by a mere perusal of the Act of Congress. In order, however, to be of assistance at this juncture, it is necessary that a treatise should be published speedily. Time is of the essence. The indulgence of the reader is, therefore, asked for any defects in this book which but for the necessity of despatch in its preparation and publication the author might have been able to remedy.

Every energy has been bent to the one object of furnishing practical assistance in what may not inappropriately be described as an emergency. The aim has been to explain whatever may be cer-

tain in respect to this statute, and to suggest debatable questions. The decisions under former federal statutes taxing incomes, or the earnings of corporations, as well as relevant decisions under the English income-tax laws, will be found, it is hoped, to be fully collected. It is believed, therefore, that the book is more than a mere "annotated edition" of the Act of Congress. In respect to points of general law — particularly of general corporation law — which have a bearing upon the new federal statute, it has seemed better usually to refer to text-books where those questions are discussed or to encyclopedias where full citations of authorities may be found, rather than to set out the authorities in full with a consequent unreasonable increase in the size of the volume and of a protracted delay in its publication.

A. W. M., JR.

BALTIMORE, January 17th, 1910.

TABLE OF CONTENTS

	PAGE
TABLE OF CASES	ix
TABLE OF FEDERAL STATUTES CITED	xxiii

CHAPTER I

§§ 1-3. INTRODUCTORY	1
--------------------------------	---

CHAPTER II

§§ 4-14. WHAT IS THE TAX ON	6
---------------------------------------	---

CHAPTER III

§§ 15-29. WHAT COMPANIES ARE SUBJECT TO THE TAX	17
--	----

CHAPTER IV

§§ 30-84. HOW THE TAXABLE INCOME IS CALCU- LATED	37
---	----

CHAPTER V

§§ 85-118. THE RETURN	103
---------------------------------	-----

CHAPTER VI

§§ 119-131. THE ASSESSMENT AND COLLECTION	139
---	-----

CHAPTER VII

§§ 132-138. REMEDIES	158
--------------------------------	-----

CHAPTER VIII

§§ 139-149. CONSTITUTIONALITY	170
---	-----

APPENDIX I

TEXT OF THE ACT OF CONGRESS	185
---------------------------------------	-----

APPENDIX II

REGULATIONS OF THE TREASURY DEPARTMENT, WITH ANNOTATIONS	201
---	-----

APPENDIX III

FORMS OF RETURNS	227
INDEX	241

TABLE OF CASES CITED

[References are to sections]

	SECTION
Adams Express Co. v. Ohio, 166 U. S. 185; 17 Sup. Ct. Rep. 604	5
Agnew v. Haymes, 141 Fed. 631	137
Alexandria Canal Co. v. The District, 5 Mackey (D. C.) 376	134
Alianza Co. v. Bell, (1906) A. C. 18	53, 57
American Sugar Ref. Co. v. Rutan, 123 Fed. 979	34, 43
Anthony v. Caswell, 15 R. I. 159; 1 Atl. 290	38
Apthorpe v. Peter Schoenhofer Brewing Co., 80 L. T. 395	34
Armour v. Roberts, 151 Fed. 846	137
Assessor v. Osbornes, 9 Wall. 567, 574	137
Attorney-General v. Till, 54 Sol. J. 132; (1909) 1 K. B. 694	105
Audenreid v. East Coast Milling Co., 124 Fed. 697	28
Bailey v. Clark, 21 Wall. 284	78
Bailey v. Railroad Co., 22 Wall. 604	74
Bailey v. Railroad Co., 106 U. S. 109; 1 Sup. Ct. Rep. 62	74
Baltzell v. Church Home & Infirmary, 110 Md. 244; 73 Atl. 151	26
Bank v. Tennessee, 104 U. S. 493	43
Bank for Savings v. Collector, 3 Wall. 295	67
Bartholomay Brewing Co. v. Wyatt, (1893) 2 Q. B. 499	37
Blacklock v. United States, 208 U. S. 75	125
Boardman v. McClure Co., 123 Fed. 614	28

[References are to sections]

	SECTION
Borough of Carlisle <i>v.</i> Marshall, 36 Pa. St. 397 . . .	38
Boske <i>v.</i> Commingore, 177 U. S. 459	128
Bradfield <i>v.</i> Roberts, 175 U. S. 291; 20 Sup. Ct. Rep. 121	18
Brampton <i>v.</i> Beddoe, 13 C. B. N. S. 538	28
Braun <i>v.</i> Sauerwein, 10 Wall. 218	137
Brickwood & Co. <i>v.</i> Reynolds, (1898) 1 Q. B. 95 . . .	47
Brown <i>v.</i> Watt, 50 J. P. 583	81
Burrough <i>v.</i> Abel, 105 Fed. 366	137
Butterworth <i>v.</i> Hoe, 112 U. S. 50; 5 Sup. Ct. Rep. 25	134
Caesar <i>v.</i> Capell, 83 Fed. 403	28
California <i>v.</i> Central Pac. R. R. Co., 127 U. S. 1; 8 Sup. Ct. Rep. 1073	145
Carey <i>v.</i> Curtis, 3 How. 236	137
Carey <i>v.</i> Savings Union, 22 Wall. 38	74
Carrick <i>v.</i> Lamar, 116 U. S. 423; 6 Sup. Ct. Rep. 424	134
Central of Ga. Ry. Co. <i>v.</i> Wright, 207 U. S. 127 . . .	107
Central Nat. Bank <i>v.</i> United States, 137 U. S. 355; 11 Sup. Ct. Rep. 126	68
Central Pac. R. R. Co. <i>v.</i> California, 162 U. S. 91; 16 Sup. Ct. Rep. 766	145
Central R. R. Co. <i>v.</i> Collins, 40 Ga. 582	47
Central Trust Co. <i>v.</i> Treat, 171 Fed. 301	43
Chadwick, <i>Re</i> , 1 Lowell, 439	108
Chadwick <i>v.</i> Pearl Life Ins. Co., (1905) 2 K. B. 507 .	36
Chamberlain <i>v.</i> Anthony, 21 R. I. 331	90
Charleston Nat. Bank <i>v.</i> Melton, 171 Fed. 743 . . .	40
Cheatham <i>v.</i> United States, 92 U. S. 85	137
Cheeseborough <i>v.</i> United States, 192 U. S. 253; 24 Sup. Ct. Rep. 262	137, 137, 138
Chicago Distilling Co. <i>v.</i> Stone, 140 U. S. 647; 11 Sup. Ct. Rep. 862	137
Chicago, etc., R. R. Co. <i>v.</i> Page, 1 Biss. 461	74
Christie-Street Commission Co. <i>v.</i> United States, 136 Fed. 326	137, 137

[References are to sections]

	SECTION
City of Lexington v. Fishback's Trustee, 60 S. W. 727; 22 Ky. Law. Rep. 1392	38
Clerical, etc., Ass. Soc. v. Carter, 22 Q. B. D. 444	43
Cleveland Trust Co. v. Lauder, 19 Oh. Circ. Ct. 217	40
Clews v. Woodstock Iron Co., 44 Fed. 31	28
Clinkenbeard v. United States, 21 Wall. 65	137
Colgate v. U. S. Leather Co., 72 Atl. 126 (N. J. Eq.)	18
Colquhoun v. Brooks, 14 A. C. 493	37
Coltness Iron Co. v. Black, 6 A. C. 315	53, 57
Commissioners v. Buckner, 48 Fed. 533	137, 137, 137
Commissioners for Income Tax v. Pemsel, (1891) A. C. 531	26
Commissioner for Taxes v. Eastern Extension etc. Tel. Co., (1906) A. C. 526	77
Commissioners of Taxation v. Kirk, (1900) A. C. 588	77
Commissioner of Patents v. Whitely, 4 Wall. 522	134
Commonwealth v. Kelley, 177 Mass. 221; 58 N. E. 691	17
Commonwealth v. Lancaster Sav. Bank, 123 Mass. 493	29
Commonwealth v. Provident Bicycle Ass'n., 178 Pa. 636; 36 L. R. A., 589; 36 Atl. 197	20
Cooper Mfg. Co. v. Ferguson, 113 U. S. 727; 5 Sup. Ct. Rep. 739	28
Cotton Press Co. v. Collector, 1 Woods, 296	138
County of Greene v. Daniel, 102 U. S. 187, 195	134
County of Ramsay v. Chicago, etc., Ry. Co., 33 Minn. 537; 24 N. W. 313	43
County of Todd v. St. Paul, etc., Ry. Co., 38 Minn. 163; 36 N. W. 109	43, 43
Crown Cork & Seal Co. v. State, 40 Atl. 1074; 87 Md. 687; 53 L. R. A. 417	40
Cummings v. Akron Cement, etc., Co., 6 Blatchf. 509, 511	17
Davenport v. County of Dodge, 105 U. S. 237	134
Davis & Rankin, etc., Co. v. Dix, 64 Fed. 406	28
DeBary v. Dunne, 162 Fed. 961	137, 137

[References are to sections]

	SECTION
Decatur <i>v.</i> Paulding, 14 Pet. 497	134
Delage <i>v.</i> Nugget Polish Co., 92 L. T. 682	36
Delaware R. Co. <i>v.</i> Prettyman, 7 Fed. Cas. 408	133, 136
Delaware Railroad Tax, <i>Re</i> , 18 Wall. 206	4
DeLima <i>v.</i> Bidwell, 182 U. S. 1; 21 Sup. Ct. Rep. 743	27
Detroit <i>v.</i> Lewis, 109 Mich. 155; 66 N. W. 958; 32 L. R. A. 439	38
Dollar Sav. Bk. <i>v.</i> United States, 19 Wall. 227, 240	114, 126
Dooley <i>v.</i> United States, 182 U. S. 222; 21 Sup. Ct. Rep. 762	27, 137
Dooley <i>v.</i> United States, 183 U. S. 151; 22 Sup. Ct. Rep. 62	27
Duke of Norfolk <i>v.</i> Lamarque, 24 Q. B. D. 485	47
East Indian Ry. Co. <i>v.</i> Secretary of State, (1905) 2 K. B. 413	36
Eastern Bldg. Assn. <i>v.</i> Bedford, 88 Fed. 7	28
Edison El. Ill. Co. <i>v.</i> United States, 38 Ct. of Cl. 208	138
Elliott <i>v.</i> Swartwout, 10 Pet. 137	137, 137
Empire Milling, etc., Co. <i>v.</i> Tombstone Mill, etc., Co. 100 Fed. 910	28, 28
Equitable Life Ass. Soc. <i>v.</i> Bishop (1900) 1 Q. B. 177	20
Erickson <i>v.</i> Last, 8 Q. B. D. 414	77
Erie Ry. Co. <i>v.</i> Pennsylvania, 21 Wall. 492-497	28
Erskine <i>v.</i> Hohnbach, 14 Wall. 613	136, 136
Erskine <i>v.</i> Van Arsdale, 15 Wall. 75	137, 137
Ewing <i>v.</i> Burnet, 11 Pet. 41, 54	17
Farrell <i>v.</i> United States, 167 Fed. 639	114, 137
Foley <i>v.</i> Fletcher, 3 H. & N. 769	36
Ford <i>v.</i> Delta, etc., Co., 164 U. S. 662, 674; 17 Sup. Ct. Rep. 230	17, 43, 69
Forder <i>v.</i> Handyside, 1 Ex. D. 233	53, 57
Fourteen Diamond Rings, 183 U. S. 176; 22 Sup. Ct. Rep. 59	27

[References are to sections]

SECTION

Frawley, Bundy & Wilcox v. Pennsylvania Casualty Co., 124 Fed. 259	28, 28
Gaines v. Thompson, 7 Wall. 347	134
Galveston, Harrisburg, etc., Ry. Co. v. Texas, 210 U. S. 217	6, 6
General Accident, etc., Corp. v. McGowan (1908) A. C. 207	58
Gibbons v. Mahon, 136 U. S. 549; 10 Sup. Ct. Rep. 1057	34
Gilchrist v. Helena, etc., R. Co., 47 Fed. 593	28
Gillatt v. Colquhoun, 33 W. R. 258	52, 57
Gleason v. McKay, 134 Mass. 419	11
Good Hope Co. v. Railway Barb Fencing Co., 22 Fed. 635	28
Grainger v. Gough (1896), A. C. 325	28, 28, 28
Gramophone & Typewriter v. Stanley, (1908) 2 K. B. 89	34, 43
Grant v. Hartford, etc., R. R. Co., 93 U. S. 225	31, 47
Gray v. Darlington, 15 Wall. 63, 66	31, 35, 35
Greene v. Mumford, 4 R. I. 313; 319-320	38
Gregg v. Sanford, 65 Fed. 151; 12 C. C. A. 525	16
Gresham Life Ass. Soc. v. Bishop, (1902) A. C. 287	37, 37
Gresham Life Ass. Soc. v. Styles, (1892) A. C. 309	58
Grove v. Young Men's Christian Assn., 88 L. T. 696	26
Gulf, etc., R. R. Co. v. Hewes, 183 U. S. 66; 22 Sup. Ct. Rep. 26	11
Guthrie v. Pittsburg, etc., Ry. Co., 138 Pa. 433	38
Haight & Freese Co. v. McCoach, 135 Fed. 894	137
Hall, John Junior & Co. v. Rickman, (1906) 1 K. B. 311	57
Hamilton Co. v. Massachusetts, 6 Wall. 632	11, 11
Hammock v. Farmers' L. & T. Co., 105 U. S. 77	17
Hazeltine v. Mississippi Fire Ins. Co., 55 Fed. 743	28
Head-Money Cases, 112 U. S. 580; 5 Sup. Ct. Rep. 247	146
Hercules Mut. Life Ass. Soc., 12 Fed. Cas. 12	20
Herold v. Kahn, 159 Fed. 608; 86 C. C. A. 598	137

[References are to sections]

	SECTION
Herold <i>v.</i> Kahn, 163 Fed. 947	137
Herold <i>v.</i> Shanley, 146 Fed. 20	137
Hesketh <i>v.</i> Bray, 21 Q. B. D. 444	47
Hicks <i>v.</i> James, 48 Fed. 542	137
Holy Trinity Church <i>v.</i> United States, 143 U. S. 457, 462	3
Home Insurance Co. <i>v.</i> New York, 134 U. S. 594; 10 Sup. Ct. Rep. 593	40
Honolulu Transit Co. <i>v.</i> Wilder, 211 U. S. 137, 142 . .	5, 11
Hubbard <i>v.</i> Collector, 12 Wall. 1	137
Hubbard <i>v.</i> Kelley, 8 W. Va. 46	137
Hunter <i>v.</i> Rex, (1904) A. C. 161	49
Illinois Central R. R. Co. <i>v.</i> Decatur, 147 U. S. 190; 13 Sup. Ct. Rep. 293	69
Illinois Central R. R. Co. <i>v.</i> Irwin, 72 Ill. 452 . . .	43
Imperial Fire Ins. Co. <i>v.</i> Wilson, 35 L. T. N. S., 271	58
Independent Ins. Co., 13 Fed. Cas. 13	20
Inhabitants of Worcester <i>v.</i> Western Railroad Co., 4 Met. 564	43
Jackson Lumber Co. <i>v.</i> McCrimmon, 164 Fed. 759 . .	129
James <i>v.</i> Hicks, 110 U. S. 272; 4 Sup. Ct. Rep. 6 . .	137
Kearns, <i>In Re</i> , 64 Fed. 481	127
Kendall <i>v.</i> Stokes, 3 How. 87	134
Kendall <i>v.</i> United States, 12 Pet. 524	134
King <i>v.</i> United States, 99 U. S. 229	114
King's County Sav. Institution <i>v.</i> Blair, 116 U. S. 200, 205; 6 Sup. Ct. Rep. 353	137, 137, 137, 138
Kinney, <i>Re</i> , 102 Fed. 468	109, 110, 127
Kinney <i>v.</i> Conant, 166 Fed. 720	137
Knowlton <i>v.</i> Moore, 178 U. S. 41; 20 Sup. Ct. Rep. 747	146, 146
Kodak, Ltd. <i>v.</i> Clark, (1903) 1 K. B. 505	34

TABLE OF CASES CITED.

XV

[References are to sections]

	SECTION
Lamar Water, etc., Co. v. Lamar, 32 L. R. A. 157, 165; 128 Mo. 188; 26 S. W. 1025; 31 S. W. 756	69
Last v. London Ass. Co., 10 A. C. 438	20
Latrobe v. Mayor, etc., of Baltimore, 19 Md. 13	38
Lawless v. Sullivan, 6 A. C. 373	33, 53
Leather Mnfrs. Nat. Bank v. Treat, 128 Fed. 262; 62 C. C. A. 644	78
Lincoln v. United States, 197 U. S. 419; 25 Sup. Ct. Rep. 455	27
Little Miami, etc., R. R. Co. v. United States, 108 U. S. 277; 2 Sup. Ct. Rep. 627	53, 53, 113, 114, 114, 122, 126
Llewellyn's Appeal, 103 Pa. 458	47
Londoner v. Denver, 210 U. S. 373	107
Lovell & Christmas v. Commissioners of Texas, (1908) A. C. 46	28, 28, 77
McClain v. Pennsylvania Co., 108 Fed. 618; 47 C. C. A. 529	137
McClung v. Silliman, 2 Wheat. 369	134
McClung v. Silliman, 6 Wheat. 598	134
McCrary v. United States, 195 U. S. 27; 24 Sup. Ct. Rep. 759	146
McCulloch v. Maryland, 4 Wheat. 316	145
McDonald v. Mass. Gen. Hospital, 120 Mass. 432; 21 Am. Rep. 529	26
McGowan v. Larsen, 66 Fed. 910; 14 C. C. A. 178	121
McIntire v. Wood, 7 Cranch, 504	134
McLeod v. Lincoln Medical College, (Neb.) 96 N. W. 265	26
Mackay v. San Francisco, 128 Cal. 678; 61 Pac. 382	38
Magee v. Denton, 5 Blatchf. 130	37
Magoun v. Illinois Trust, etc., Co., 170 U. S. 283; 18 Sup. Rep. 594	146
Maine v. Grand Trunk Ry. Co., 142 U. S. 217; 12 Sup. Ct. Rep. 121, 163	10, 142
Mandell v. Pierce, 3 Cliff. 135	29

[References are to sections]

	SECTION
Manhattan Co. v. Blake, 148 U. S. 412; 13 Sup. Ct. Rep. 640	40
Mansfield v. Excelsior Refining Co., 135 U. S. 326	125
Marbury v. Madison, 1 Cranch, 137	134, 134
Marsh v. Sanders, 110 La. 726; 34 So. 752	116
Memphis City v. Dean, 8 Wall. 64, 73	133
Merchants Ins. Co. v. McCartney, 1 Lowell, 447	34, 39
Mersey Docks v. Lucas, 8 A. C. 891	17
Miles v. Johnson, 59 Fed. 38	133
Missouri River, etc., Co. v. United States, 19 Fed. 66	126
Morrill v. Jones, 106 U. S. 466; 1 Sup. Ct. Rep. 423	90
Murdoch v. Ward, 178 U. S. 139; 20 Sup. Ct. Rep. 775	40
Mutual Life Ins. Co. v. Speatley, 172 U. S. 602	28, 28
 National Union v. Marlow, 74 Fed. 775; 21 C. C. A. 89	 24
New York, Lake Erie, etc., Co. v. Pennsylvania, 158 U. S. 431; 15 Sup. Ct. Rep. 900	40
New York Life Ins. Co. v. Styles, 14 A. C. 381	20
New York State v. Roberts, 171 U. S. 658; 19 Sup. Ct. Rep. 58	4, 78
Norton v. Atchison, etc., R. Co., 61 Fed. 618	28
 Oakland Sugar Mill Co. v. Wolf Co., 118 Fed. 239; 55 C. C. A. 193	 28
 Pacific Ins. Co. v. Soule, 7 Wall. 433	 142
Paddington Burial Board v. Commissioners of Inland Revenue, 13 Q. B. D. 9	26
Palmer v. McMahon, 133 U. S. 660, 669; 18 Sup. Ct. Rep. 324	107
Patton v. Brady, 184 U. S. 608; 22 Sup. Ct. Rep. 493	144, 146
People v. Am. Bell. Tel. Co., 117 N. Y. 241; 22 N. E. 1057	28, 78, 78
People v. Board of Trade, 80 Ill. 134, 136	17
People v. Campbell, 138 N. Y. 543; 34 N. E. 370; 20 L. R. A. 453	28, 78, 78, 78

TABLE OF CASES CITED.

xvii

[References are to sections]

	SECTION
People v. Coleman, 119 N. Y. 137; 23 N. E. 488; 7 L. R. A. 407	38
People v. Neff, 34 N. Y. App. Div. 83	18, 26
People v. Wemple, 117 N. Y. 136; 6 L. R. A. 303; 22 N. E. 1046	16
People v. Wemple, 133 N. Y. 323; 31 N. E. 238	78
People v. Wemple, 148 N. Y. 690; 43 N. E. 176	78, 78
People ex rel. Devoe Co. v. Roberts, 51 N. Y. App. Div. 77; 64 N. Y. Supp. 494	44
People ex rel. Fort George Realty Co. v. Miller, 179 N. Y. 49	78
People ex rel. Niagara, etc., Co. v. Roberts, 30 N. Y. App. Div. 180; 157 N. Y. 676	78
People ex rel. Singer Mfg. Co. v. Wemple, 150 N. Y. 46	78
People ex rel. Union Trust Co. v. Coleman, 126 N. Y. 433; 27 N. E. 818; 12 L. R. A. 762	61
People ex rel. Wall, etc., Co. v. Miller, 181 N. Y. 328	44, 78
Philadelphia Contributorship v. Commonwealth, 98 Pa. 48	40, 53
Philadelphia, etc., S. S. Co. v. Pennsylvania, 122 U. S. 326; 7 Sup. Ct. Rep. 1118	11, 40
Plummer v. Coler, 178 U. S. 115; 20 Sup. Ct. Rep. 829	4, 40
Pollock v. Farmers' L. & T. Co., 157 U. S. 429; 15 Sup. Ct. Rep. 673; 158 U. S. 601; 15 Sup. Ct. Rep. 912	40, 41, 42, 130, 130, 133, 141, 143, 144, 149
Pommery v. Apthorpe, 56 L. J. Q. B. 155	28
Ponce v. Roman Catholic Church, 210 U. S. 296, 309	27
Powell v. United States, 135 Fed. 881	90
Provident Inst. v. Massachusetts, 6 Wall. 611	11
Railroad v. Berks County, 6 Pa. St. 70	43
Railroad Co. v. Collector, 100 U. S. 595	4
Redding, Re, (1897) 1 Ch. 876	33
Reid's Brewery Co. v. Mole, (1891) 2 Q. B. 1	43
Rex v. Special Commissioner, 98 L. T. 446	26
Reynolds v. Williams, 4 Biss. 108	34

[References are to sections]

	SECTION
Rhymney Iron Co. v. Fowler, (1896) 2 Q. B. 79 . . .	47
Richardson v. Boston, 148 Mass. 508; 20 N. E. 166 . . .	38
Royal Ins. Co. v. Watson, (1897) A. C. 1 . . .	47
Russell v. Town & County Bank, 13 A. C. 418 . . .	45, 47
St. Andrew's Hospital v. Shearsmith, 19 Q. B. D. 624 . . .	26
St. Louis Bldg., etc., Ass'n v. Lightner, 47 Mo. 393 . . .	40
St. Louis Breweries v. Apthorpe, 79 L. T. 551 . . .	34
St. Louis Wire-Mill Co., 32 Fed. 802 . . .	28
Salt Lake City v. Hollister, 118 U. S. 256; 6 Sup. Ct. Rep. 1055 . . .	44
Santa Clara Female Academy v. Sullivan, 116 Ill. 375; 6 N. E. 183; 56 Am. Rep. 776 . . .	26, 28
Schafer v. Craft, 144 Fed. 907 . . .	127
Schuylkill Nav. Co. v. Elliott, 21 Fed. Cas. 762 . . .	148
Schwarzchild v. Rucker, 143 Fed. 656 . . .	137, 137
Scott v. Abbott, 160 Fed. 573 . . .	63
Scottish Provident Ass'n v. Allan, (1903) A. C. 129 . . .	33, 37
Scottish Union, etc., Ins. Co. v. Bowland, 196 U. S. 611 . . .	78
Secretary of State v. Scoble, (1903) A. C. 299 . . .	36
Selden v. Equitable Trust Co., 94 U. S. 419 . . .	67
Sheffield, Re, 64 Fed. 833 . . .	145
Sheridan v. Allen, 153 Fed. 568; 82 C. C. A. 522 . . .	125
Sioux City & Pac. R. R. Co. v. United States, 110 U. S. 205; 3 Sup. Ct. Rep. 565 . . .	65
Smith v. Grayson County, (Texas) 44 S. W. 921, 923 . . .	47
Snyder v. Marks, 109 U. S. 189; 3 Sup. Ct. Rep. 157 . . .	133
Society for Savings v. Coite, 6 Wall. 594 . . .	11, 40
South Carolina v. United States, 199 U. S. 437; 26 Sup. Ct. Rep. 110 . . .	145
Southwell v. Savill Bros., (1901) 2 K. B. 349 . . .	47
Southwestern R. R. Co. v. Wright, 116 U. S. 231; 6 Sup. Ct. Rep. 375 . . .	43
Speer v. Colbert, 200 U. S. 130; 26 Sup. Ct. Rep. 201 . . .	18
Spreckels Sugar Ref. Co. v. McClain, 192 U. S. 397; 24	

TABLE OF CASES CITED.

xix

[References are to sections]

SECTION

Sup. Ct. 376; 113 Fed. 244; 51 C. C. A. 201	
29, 39, 43, 43, 43, 90, 142, 146	
Spreckels Sugar Ref. Co. v. McClain, 109 Fed. 76	29, 39
Stanley v. Supervisors of Albany, 121 U. S. 535, 550-	
551; 7 Sup. Ct. Rep. 1234	137
State v. B. & O. R. R. Co., 48 Md. 49, 80	43, 43, 43
State v. Collector, 25 N. J. Law Rep. 315	43
State v. Commissioners of Mansfield, 23 N. J. Law 510;	
57 Am. Dec. 409-n.	43
State v. Taylor, (Ill.) 89 N. E. 271	61
State v. Willard, 77 Minn. 190; 79 N. W. 829	38
Stevens v. Bishop, 20 Q. B. D. 442	47
Stockard v. Morgan, 185 U. S. 27; 22 Sup. Ct. Rep. 576	6
Stockdale v. Insurance Co., 20 Wall. 323	148
Strong & Co. v. Woodfield, (1906) A. C. 448	47, 81
Stutsman County v. Wallace, 142 U. S. 293; 12 Sup.	
Ct. Rep. 297	136
Sullivan v. Sheehan, 89 Fed. 247	28
Sully v. Attorney-General, 5 H. & N. 711	77
Swigert, <i>Re</i> , 119 Ill. 83; 6 N. E. 469	43
 Tennant v. Smith, (1892) A. C. 150	 33
Thatcher v. United States, 15 Blatchf. 15	90
Tischler v. Apthorpe, 52 L. T. N. S. 814	28
Tucker v. Ferguson, 22 Wall. 527, 575	42
Tucker v. Grier, 160 Fed. 611; 87 C. C. A. 513	127, 137
Turner v. Evans, 2 E. & B. 512	28
Tyrrell v. Mayor, etc., of New York, 159 N. Y. 239;	
53 N. E. 1111	17
 United States v. Am. Bell. Tel. Co., 29 Fed. 17	 28
United States v. Black, 128 U. S. 40; 9 Sup. Ct. Rep.	
12	134, 134
United States v. Blaine, 139 U. S. 306; 11 Sup. Ct.	
Rep. 607	134

[References are to sections]

	SECTION
United States <i>v.</i> Central Natl. Bank, 137 U. S. 255; S. C. 10 Fed. 612	53, 54
United States <i>v.</i> Eaton, 144 U. S. 677	90, 101
United States <i>v.</i> Fisher, 2 Cranch, 358	3
United States <i>v.</i> Frost, 25 Fed. Cas. 1221	37
United States <i>v.</i> Isham, 17 Wall. 496	17
United States <i>v.</i> Hyams, 146 Fed. 15	90
United States <i>v.</i> Lacher, 134 U. S. 624; 10 Sup. Ct. Rep. 625	17
United States <i>v.</i> Lamson, 165 Fed. 80	90, 90
United States <i>v.</i> Lamson, 173 Fed. 673	90, 101
United States <i>v.</i> Little Miami, etc., R. R. Co., 1 Fed. 700	113, 114, 114, 122
United States <i>v.</i> Louisville & N. R. Co., 33 Fed. 829	49
United States <i>v.</i> Mann, 95 U. S. 580	130
United States <i>v.</i> Marion Trust Co., 143 Fed. 301; aff. 205 U. S. 539	114
United States <i>v.</i> Marquette, etc., R. Co., 17 Fed. 719	126
United States <i>v.</i> Mayer, Deady, 127	37, 54
United States <i>v.</i> Morse, 161 Fed. 429	63
United States <i>v.</i> Palmer, 3 Wheat. 610	3
United States <i>v.</i> Philadelphia, etc., R. R. Co., 123 U. S. 113; 8 Sup. Ct. Rep. 77	113
United States <i>v.</i> Railroad Co., 17 Wall. 322	4
United States <i>v.</i> Rindskopf, 105 U. S. 418	137
United States <i>v.</i> Savings Bank, 104 U. S. 728	137, 138, 138
United States <i>v.</i> Schillinger, 14 Blatchf. 71	37
United States <i>v.</i> Schurz, 102 U. S. 378	134
United States <i>v.</i> Smith, 1 Sawy. 277	35, 37
United States <i>v.</i> Snyder, 149 U. S. 210	125
United States <i>v.</i> Three Railroad Cars, 1 Abb. (U. S.) 196	17
United States <i>v.</i> Two Hundred Barrels of Whiskey, 95 U. S. 571	90
United States <i>v.</i> U. S. Fidelity & Guaranty Co., 144 Fed. 866	101

TABLE OF CASES CITED.

xxi

[References are to sections]

	SECTION
United States <i>v.</i> U. S. Fidelity & Guaranty Co., 158 Fed. 604	101
United States <i>v.</i> Windom, 137 U. S. 636; 11 Sup. Ct. Rep. 197	134
Van Dresser <i>v.</i> Oregon Ry., etc., Co., 48 Fed. 202 .	28
Veazie Bank <i>v.</i> Fenno, 8 Wall. 533	145
Vermont Central R. Co. <i>v.</i> Burlington, 28 Vermont, 193	43
Watson <i>v.</i> Royal Ins. Co., (1896) 1 Q. B. 41 . . .	47
Watson <i>v.</i> Sandie, (1898) 1 Q. B. 326	28
Webber Hospital Ass'n <i>v.</i> McKenzie, (Me.) 71 Atl. 1062	18
Werle & Co. <i>v.</i> Colquhoun, 20 Q. B. D. 753 . . .	28, 28
Western Union Tel. Co. <i>v.</i> Massachusetts, 125 U. S. 530; 8 Sup. Ct. Rep. 961	142
Westhus <i>v.</i> Union Trust Co., 164 Fed. 795; 90 C. C. A. 441	114
Wright <i>v.</i> Blakeslee, 101 U. S. 174	137, 137

TABLE OF FEDERAL STATUTES CITED

[References are to sections]

	SECTION
REVISED STATUTES	
Section 1	130n.
Section 5	29
Section 161	128
Section 251	88, 128
Section 321	90n., 129
Section 3152	104
Section 3163	106, 130
Section 3164	130
Section 3165	88, 130
Section 3169	130
Title 35, Chapter 2 (heading)	129n.
Section 3172	106
Section 3173	130
Section 3174	130
Section 3175	109, 130
Section 3176	130
Section 3177	130
Section 3179	130
Section 3180	130
Section 3182	129
Section 3183	123
Section 3184	130
Sections 3187-3195	125
Sections 3196-3205	125

xxiv TABLE OF FEDERAL STATUTES CITED.

[References are to sections]

	SECTION
REVISED STATUTES — <i>Continued</i>	
Section 3205	125
Section 3206	125
Section 3207	125
Section 3209	125
Section 3214	126n.
Section 3220	138
Section 3224	132
Section 3226	137
Section 3227	137
Section 3228	138
Section 3249	90n.
ACT, Aug. 15, 1876, c. 304	88
ACT, March 1, 1879, c. 125	
Section 2	104, 130
Section 3	125
ACT, Aug. 27, 1894, c. 349 (Income Tax Law)	
Section 28	69
Section 34	130
Section 36	101
ACT, May 28, 1896, c. 252, section 19	88
ACT, June 13, 1898, c. 448 (War Revenue Act), sec-	
tion 28	43
ACT, March 2, 1901, c. 814	88
ACT, May 9, 1902, c. 784 (Oleomargarine Act), sec-	
tion 6	101n.
ACT, Aug. 5, 1909, c. 6	
Title	3
Section 1	27
Section 5	27
Section 38	
Par. 1 . 5, 6, 9, 10, 15, 17, 19, 21, 22, 23, 24, 25,	
26, 27, 28, 29, 37, 38, 44A, 45, 84A, 121	
Par. 2 . 10, 27, 31, 33, 45, 46, 49, 50, 53, 55, 57,	

TABLE OF FEDERAL STATUTES CITED. XXV

[References are to sections]

SECTION

ACT, Aug. 5, 1909, Par. 2 — *Continued*

	58, 59, 60, 61, 62, 63, 65, 67, 68, 71, 72, 74, 78, 80, 81, 82, 83, 84, 84A
Par. 3 .	27, 45, 50, 84A, 86, 87, 88, 89, 90, 91, 92, 93, 94, 95, 96, 97, 98, 99, 99A, 101, 102
Par. 4 . . .	104, 106, 107, 108, 109, 110, 112
Par. 5 . . .	86, 103, 112, 113, 119, 121, 122, 123
Par. 6	102, 116
Par. 7	117
Par. 8 .	104, 109, 115, 118, 121, 123, 125, 127, 132
Section 42	29, 39

FEDERAL CORPORATION TAX LAW

CHAPTER I

INTRODUCTORY

§ 1 Origin of the tax.

§ 2 Its form.

§ 3 Purpose of the law—general rule of construction.

§ 1. **Origin of the Tax.** — The new federal tax on corporations and companies is the resultant of several political forces which were brought into play during the discussion of the Tariff Act of 1909. Congress, it will be remembered, had convened upon the call of the President in extraordinary session for the purpose, as many people hoped and as a few believed, of reducing the tariff duties upon imports. A bill for that purpose, in accordance with the constitutional requirement, could only originate in the House of Representatives. Accordingly, a comprehensive tariff bill was introduced in that body, and under its expeditious rules

was speedily passed. When this bill reached the Senate, however, it was subjected to considerable discussion. A large number of Senators, for one reason or another, were in favor of incorporating in the bill a provision for a tax upon incomes, both of individuals and of corporations. The dominant party, or faction, was opposed to this measure, for reasons which it is not now material to inquire into. They were obliged to admit, however, that the scale of duties on imports which they were desirous of maintaining and which the bill provided for, would not, in all probability, raise sufficient revenue to supply the needs of the government. Possibly, had the tariff duties been reduced, so as to remove the virtual embargo which they imposed on many articles of foreign commerce, this prospective deficit might have been averted; but that remedy was regarded as even worse than an income tax. Yet so long as the proposed income tax was the only suggested source of additional revenue, as an alternative to the inadmissible plan of reducing duties on imports, there was a strong probability that an income tax would be adopted. In vain the powers-that-be argued that an unapportioned income tax would certainly be pronounced unconstitutional by the Supreme Court, and that the government would thus be left without adequate revenue, as was the case when the Income Tax of 1894 met a similar fate. In spite of all these arguments, the adoption of an income tax by the Senate seemed imminent.

At this point, a plan was devised — by whom we need not stop to inquire — which, it was supposed, would raise sufficient revenue, would avoid the constitutional objections to a general income tax, and would at the same time enable the leaders of the Senate to escape the humiliation of a defeat upon the proposed income-tax amendment to the tariff bill. This plan was a so-called excise tax on corporations and companies in proportion to their income. This plan was incorporated in an amendment to the tariff bill, which was adopted in the Senate, and concurred in by the House of Representatives. The bill including this feature was signed by the President on August 5th, 1909.

§ 2. **Its Form.** — Thus it comes about that the so-called corporation tax is embodied in a single section of the Tariff Act — numbered Section Thirty-eight. This Section embraces substantially all of the provisions of the very voluminous statute (which appears as Chapter Six of the Acts of the Sixty-first Congress) that in any way relate to the corporation tax. The other provisions relate to duties on imports, to the creation of a Court of Customs Appeals, and to some other more or less connected topics. Section Thirty-eight, which will be found in the Appendix, is of considerable length, and is itself divided into several numbered subsections, — themselves of no inconsiderable length — which in this book will be referred to as Paragraphs. As these Paragraphs are, some of them, so long that a mere reference to Paragraph One,

Two, Three or Four, as the case might be, would often require the reader to search through an involved mass of print in order to discover the particular passage intended, it has seemed desirable to number the lines of these paragraphs. Accordingly, the lines of each numbered Paragraph of Section Thirty-eight will be found in the Appendix to be numbered by numerals in the margin. It is to those lines as printed in this Appendix, and not to the numbers of the lines in the official text of the Act as printed in the Statutes at Large, that references are made throughout this book.¹

§ 3. **Purpose of the Law — General Rule of Construction.** — It is perhaps not superfluous to say that the primary object of the law, as a revenue law, is to produce revenue. Nevertheless, it is pertinent to mention that the title of the Act sets out as one of its objects to “encourage the industries of the United States.”² There is no reason to confine this object to so much of the Act as levies duties on imports. On the contrary, it may well indicate that no unnecessary burdens were intended to be imposed on “the industries of the United States,” and may properly induce the courts in any doubtful case to incline towards a construction which will “encourage” those

¹ The method of citation is on this order, “Act, Par. 1, line 1.” Wherever the word “Act” is used in citations without mentioning date or chapter, it is to be understood that reference is had to the Act of Aug. 5th, 1909, c. 6, § 38.

² See *infra* Appx. I.

industries, or at least will not discourage them by the imposition of unduly grievous burdens.¹ “The industries of the United States” are, to a vastly preponderating extent, carried on by corporations which are subject to this tax, and it would be a poor way to “encourage” them to impose on them such heavy burdens and to subject them on mere suspicion to such inquisitorial examination and ruinous publicity, as to compel many of them to quit business. Such a method of encouragement would be that of the French captain who hanged a number of his men from the yard-arms “pour encourager les autres.” Especially in view of the title of the Act, the courts should lean against a construction that would produce such results.

¹ That in construing an Act of Congress the courts may properly be influenced by its title, see *Holy Trinity Church v. United States*, 143 U. S. 457, 462; *United States v. Fisher*, 2 Cranch 358, 386; *United States v. Palmer*, 3 Wheat. 610, 631.

CHAPTER II

WHAT THE TAX IS ON

- § 4 How to determine what property or rights a tax is levied upon — in general.
- §§ 5-10 Is this tax levied upon the business or upon the income?
- § 5 Discordant provisions of the Act.
- § 6 Name of tax not conclusive.
- § 7 Statement of question — Is the income a mere measure of the business?
- § 8 Tax not laid on all who do business.
- § 9 Is the tax laid on companies which do no business?
- § 10 Tax not gauged by amount of business but by amount of income from all sources.
- § 11 Tax not laid on franchise to be a corporation.
- § 12 On privilege of having a share-capital?
- § 13 Not a tax on dividends.
- § 14 Differences from an income tax.

§ 4. **How to Determine what Property or Rights a Tax is Levied upon — In General.** — A question the determination of which will control many subordinate questions as to the construction of the Act is, "Upon what is the tax laid?" Is it a tax upon the property of the companies, or upon their income, or upon their "franchise" or business?

Now, *prima facie* a tax is laid upon that in proportion to which its amount is gauged. It is true that a tax upon one right or privilege, particularly some intangible right or privilege, may be laid in proportion to the value of some other property without being a tax upon that property;¹ but this is only true where the value of the property by which the tax is gauged is a reasonable measure of the value of the intangible right or privilege, or where the intangible right might be altogether taken away by the taxing government and may therefore be conceded on such conditions as that government pleases.²

¹ For example, an excise tax on the business of a corporation may be proportioned to the amount paid out by the company for dividends on its stock and interest on its bonded debt: *Railroad Co. v. Collector*, 100 U. S. 595 (to be compared with *United States v. Railroad Co.*, 17 Wall. 322). So, a tax on the privilege of taking property by will may be proportioned to the value of the property so passing, and is not on that account converted into a tax on the property: *Plummer v. Coler*, 178 U. S. 115. And a tax on corporations on the amount of "capital employed" in the state is not invalid because some of that capital may consist of articles of interstate commerce in the original packages: *New York State v. Roberts*, 171 U. S. 658, 664; 19 Sup. Ct. Rep. 58. Moreover, a tax may be laid on an interstate railway company graduated according to the cash value of so many of its shares of stock as bear to the whole number of shares the same proportion that its length of railway within the state bears to its total length; and such a tax though proportioned to the value of the shares is not a tax on the shares: *Delaware Railroad Tax*, 18 Wall. 206.

² Cf. *infra* § 40.

For instance, if a tax were laid on corporations in proportion to the value of the real estate owned by them, few persons would deny the tax to be a tax on land, although it might not be so denominated by the legislature.

§ 5. **Is this Tax Levied upon the Business or upon the Income? — Discordant Provisions of the Act.** — Now, the present tax is expressed to be laid on the companies “with respect to the carrying on or doing business.”¹ This would apparently indicate that the tax is laid on the intangible right sometimes designated as goodwill — that peculiar value which springs into being when tangible property is joined together by unity of use as “a single producing plant.”² The tax is not, however, directly proportioned to the amount of business done, nor to the amount of income derived therefrom, but to the net income received by the company “from all sources,”³ including income from invested property as well as from the transaction of the company’s business.

§ 6. **Name of Tax not Conclusive.** — Now, the legislative declaration that the tax is laid “with respect to the carrying on or doing business” is not conclusive, if the courts can see that notwithstanding its name the tax is in fact laid upon in-

¹ Act, Par. 1, lines 14-15 (infra Appx. I).

² *Adams Express Co. v. Ohio*, 166 U. S. 185; 17 Sup. Ct. Rep. 604; *Honolulu Translt Co. v. Wilder*, 211 U. S. 137, 142.

³ Act, Par. 1, line 19 (infra Appx. I).

come,¹ although undoubtedly a very high degree of deference will be paid to the designation of the tax by Congress as an excise tax on the transaction of business. So also, there is no difference between a tax "equal to," or as this Act says "equivalent to,"² so much per cent of the income, and a tax on the income, of so much per cent.³

§ 7. **Statement of Question — Is the Income a Mere Measure of the Business?** — The question in the last analysis is this: Is the tax really though not nominally a tax on income, or is the income merely used as a convenient and proper index to the value or amount of the business? It should be remembered that a tax on the business is what is often designated — though in the writer's opinion inappropriately designated — as a franchise tax.⁴

§ 8. **Tax not Laid on all who do Business.** — The fact that the tax is not laid upon all persons who do business, but only upon companies, is not conclusive to show that it is not a tax on the business. There may be a tax on the transaction of business without subjecting to the tax everybody who transacts business. The exemptions may con-

¹ *Galveston, Harrisburg, etc., Ry. Co. v. Texas*, 210 U. S. 217. Cf. *Stockard v. Morgan*, 185 U. S. 27, 37; 22 Sup. Ct. Rep. 576.

² Act, Par. 1, line 17 (*infra* Appx. I).

³ *Galveston, Harrisburg, etc., Ry. Co. v. Texas*, 210 U. S. 217, 227-228; 20 Sup. Ct. Rep. 829.

⁴ See *infra* § 11.

ceivably destroy the uniformity of the tax, and render the act obnoxious to constitutional objections on the score of inequality; but they do not show that the tax is other than what it is denominated by the legislature — a tax on business. Indeed, if the tax is to be deemed an income tax, it must still be acknowledged that it is not laid upon all persons who enjoy incomes.

§ 9. **Is the Tax laid on Companies which do no Business?** — If, however, the tax is laid upon companies which do *no* business, it cannot be a tax on business. You cannot tax a company on a business which it has not. Now, in the case of domestic companies, there is no express exemption of those companies which are not carrying on business: the language is general — “*every* corporation, joint stock company or association, organized for profit and having a capital stock represented by shares, and every insurance company, now or hereafter organized under the laws of the United States or of any State or Territory of the United States or under the acts of Congress applicable to Alaska, . . . shall be subject to pay annually a special excise tax.”¹ If, however, the tax is a tax on business, then it must be held that domestic companies which do no business shall pay no tax, even though they may derive an income from invested property. In this aspect, it is as if a law should provide that every corporation shall be subject to pay a tax on its real estate; for in

¹ Act, Par. 1, lines 1-14 (*infra* Appx. I).

that case nobody would claim that a corporation owning no land should nevertheless pay a tax.

In truth, in respect to the question whether domestic companies which are doing no business but which derive an annual income exceeding five thousand dollars from invested capital are liable to tax, two clauses of the Act are in conflict. On the one hand, if effect is to be given to the provision that the tax is laid "with respect to the carrying on or doing business," then such companies are not liable to the tax; but if, on the other hand, effect is to be given to the other provision of the same section that all domestic companies having a capital stock divided into shares shall pay a tax equal to one per cent of the net income over and above five thousand dollars received during the year from all sources, the tax in the case suggested would be payable. The question is whether the apparent intention to exact a tax if any of the companies described in the Act receives an income, from any source, in excess of five thousand dollars is overbalanced by the express provision that the tax is laid on the transaction of business. In order to determine this, we must look at other portions of the Act.

In respect to foreign companies, the Act explicitly states that only such companies as are "engaged in business in any State or Territory of the United States or in Alaska or in the District of Columbia," are liable to the tax.¹ It is, therefore,

¹ Act, Par. 1, lines 9-12 (*infra* Appx. I).

clear that a foreign company which does no business¹ is not subject to tax, although it may derive an income from capital invested in the United States.

§ 10. **Tax not Gauged by Amount of Business but by Amount of Income from all Sources.** — It is quite clear that the tax with respect both to domestic and to foreign companies is not at all graduated according to the amount of business done, and that a diminution in the amount of business does not necessarily work any corresponding diminution in the amount of the tax. This is clear enough even in the case of a domestic company; for the Act expressively provides that the amount of the tax shall be one per cent of the income “received by it *from all sources*,”² and not merely from its business. Though the business were carried on at a loss, yet if the losses were overbalanced to the extent of five thousand dollars by income from investments, the tax would be payable. As to foreign companies, the Act is if possible still more express, for it provides that the tax shall be one per cent on the net income in excess of five thousand dollars received “from business transacted *and capital invested* within the United States.”³ These circumstances cer-

¹ As to what is “doing business,” see *infra* § 28.

² Act, Par. 1, line 19 (Appx. I).

³ Act, Par. 1, lines 27–28 (*infra* Appx. I). So, Paragraph 2 provides that the net income of a foreign company subject to the tax shall be calculated by making certain deductions

tainly *tend* to show that the tax is really laid on income and not, as it purports to be, on the carrying on of business. For while a tax on business may appropriately be measured by the amount of income received from that business,¹ yet it is difficult to see how it can be affected by the amount of income received from other sources without losing its character as a tax on business.²

Moreover, as will be explained below, there is on the face of the Act a doubt whether income received by the company as trustee is to be included in the assessment. If so, that fact certainly goes a long way towards showing that the tax is really laid on income and not on business.

§ 11. **Tax not laid on Franchise to be a Corporation.** — The tax certainly cannot be regarded as laid upon the so-called “franchise” or privilege of being a corporation; for the Act is expressly applicable not only to corporations but also to many unincorporated bodies, namely, “every joint from “the gross amount of its income received within the year from business transacted *and capital invested* within the United States.” See *infra* § 78.

So the return on behalf of a foreign company must state the gross income received from “business transacted *and capital invested*” in the United States. See *infra* § 93.

¹ *Maine v. Grand Trunk Ry. Co.*, 142 U. S. 217, 228-229; 12 Sup. Ct. Rep. 121, 163.

² Compare cases cited *infra* § 40. See also an elaborate and valuable note in 57 L. R. A. 48-53, where a full collection will be found of the then existing authorities upon the distinction between a property tax and a franchise tax, or tax on the business.

stock company or association organized for profit and having a capital represented by shares.”¹ This is sufficient to dispose of any contention that the tax is laid on any corporate franchise or privilege, if there be any such thing under modern liberal incorporation laws.² Taxes on the business of corporations are often spoken of, even by the best authorities, as franchise taxes;³ but those

¹ Cf. *Gleason v. McKay*, 134 Mass. 419 (where a statute purporting to extend to unincorporated companies a tax laid by a previous statute on the “franchises” of certain corporations — substantially the same statute which was held constitutional in *Hamilton Co. v. Massachusetts*, 6 Wall. 632 — was held unconstitutional because the unincorporated companies had no “franchises”); *Philadelphia, etc., S. S. Co. v. Pennsylvania*, 122 U. S. 326, 342; 7 Sup. Ct. Rep. 1118 (where the court reasoned that a certain tax “certainly could not have been intended as a tax on the corporate franchise, because, by the terms of the act, it was laid equally on the corporations of other states doing business in Pennsylvania”).

² See 1 Machen, *Modern Law of Corps.*, § 19, § 20. Although there may not be any “franchise to be a corporation,” in the proper sense of those words, under modern incorporation laws; yet there is certainly a *right* to be a corporation, although that right is free to everybody. And the exercise of this right may be taxed, just as, for example, the exercise of the right to execute a conveyance of land may be taxed.

³ *Provident Inst. v. Massachusetts*, 6 Wall. 611; *Society for Savings v. Coite*, 6 Wall. 594; *Honolulu Transit Co. v. Wilder*, 211 U. S. 137. A so-called “privilege tax” on corporations is a tax on property; *Gulf, etc., R. R. Co. v. Hewes*, 183 U. S. 66; 22 Sup. Ct. Rep. 26; but not of course on the tangible property of the corporation. *Hamilton Co. v. Massachusetts*, 6 Wall. 632.

expressions can hardly be taken as conclusive of the propriety of that terminology.¹ Still less can they properly be used as a basis for the deduction that such a tax, if laid by Congress, would be an unconstitutional burden on a state franchise or agency.²

§ 12. **On Privilege of Having a Share-Capital?** — It may be said, however, that the tax is upon the privilege of having a capital stock represented by shares. This can hardly be, however; for the Act applies to *all* insurance companies, even those which have no capital stock.³ Moreover, although the right to have a capital stock divided into shares is of some value, yet it is hardly reasonable to say that it bears any relation to the total amount of net income from all sources received by the company, in proportion to which this tax is graduated.

§ 13. **Not a Tax on Dividends.** — This tax is certainly not a tax on dividends; for the tax is payable although no dividends are declared. The company may choose to accumulate its earnings as a surplus or reserve; and yet the tax would be payable on the net income in excess of \$5,000. Moreover, as shown below, in some circumstances where dividends may be declared and paid, even to an amount exceeding five thousand dollars, yet

¹ It is submitted that a more accurate, though more cumbersome, name is "tax on business transacted," or, more briefly, "business tax."

² See *infra* § 145.

³ See *infra* § 20.

the tax would not be payable.¹ A tax on dividends paid to shareholders is doubtless an excise; but this is not such a tax.

§ 14. **Differences from an Income Tax.** — If the tax is not a tax on income, it has all the appearances of such a tax. Its amount is to be calculated for all the world like the amount of an income tax. It differs from an income tax in but two respects at most — (1) in name, and (2) in that it is not, perhaps, payable unless the company in question is doing some business of some kind.²

¹ *Infra* § 31.

² Whether in such a case the tax would be payable, see *supra* § 8.

CHAPTER III

WHAT COMPANIES ARE SUBJECT TO THE TAX

- § 15 In general.
- § 16 Unincorporated companies.
- § 17 "Organized for profit."
- § 18 How objects of company determined for purposes of the Act.
- § 19 "Having a capital stock represented by shares."
- § 20 Insurance companies.
- §§ 21-26 Expressly excepted classes of companies.
- § 21 In general.
- § 22 Labor organizations.
- § 23 Agricultural or horticultural organizations.
- § 24 Fraternal beneficiary societies.
- § 25 Building and loan associations.
- § 26 Religious, charitable or educational corporations.
- §§ 27-29 Foreign companies.
- § 27 Line of demarkation between foreign and domestic companies.
- § 28 What is "engaged in business in the United States."
- § 29 Corporations organized or dissolved with the year, etc.

§ 15. **In General.** — The class of companies subject to the Act is thus defined:

"Every corporation, joint stock company or association, organized for profit and having a capital stock represented by shares, and every insurance

company, now or hereafter organized under the laws of the United States or of any State or Territory of the United States, or under the Acts of Congress applicable to Alaska or the District of Columbia, or now or hereafter organized under the laws of any foreign country and engaged in business in any State or Territory of the United States or in Alaska or in the District of Columbia. . . . Provided, however, that nothing in this section contained shall apply to labor, agricultural, or horticultural organizations, or to fraternal beneficiary societies, orders, or associations operating under the lodge system, and providing for the payment of life, sick, accident, and other benefits to the members of such societies, orders or associations, and dependents of such members, nor to domestic building and loan associations, organized and operated exclusively for religious, charitable, or educational purposes, no part of the net income of which enures to the benefit of any private stockholder or individual."

§ 16. **Unincorporated Companies.** — It will be observed that the Act applies not only to corporations, but also to unincorporated companies organized for profit, and having a capital represented by shares. The word "companies" is undoubtedly sufficient to cover unincorporated concerns,¹ and the same is true of the word "associations."²

¹ As to the meaning of the word, see 1 Machen, Mod. Law of Corps., § 30. The word "corporation," of course, does not include unincorporated joint-stock companies: *Gregg v. Sanford*, 65 Fed. 151; 12 C. C. A. 525.

² See *People v. Wemple*, 6 L. R. A. 303; 117 N. Y. 136 (where the very words, "corporation, joint stock company or association," in a tax law were held applicable to a volun-

§ 17. “Organized for Profit.” — These words,¹ together with the adjective clause by which they are followed, namely, “having a capital stock represented by shares,” probably apply to “corporation” as well as to “joint stock company or association,” and therefore only such corporations as are “organized for profit” are subject to the tax. Such at any rate must be the interpretation, unless the comma which follows the word “association” is to be disregarded; and the punctuation of a statute, although entitled to but slight consideration, and sometimes treated as no part of the statute at all,² yet may be looked at for guidance where the words unpunctuated are ambiguous.³ The only argument against reading the words “organized for profit” as applicable to

tary association formed by articles of agreement which contained no reference to any statute but which purported to confer certain quasi-corporate powers which would only be lawful under certain enabling statutes).

¹ Act, Par. 1, lines 2-3 (*infra* Appx. 1).

² *United States v. Isham*, 17 Wall. 496; *Hammock v. Farmers L. & T. Co.*, 105 U. S. 77; *United States v. Lacher*, 134 U. S. 624; 10 Sup. Ct. Rep. 625; *Ford v. Delta, etc., Co.*, 164 U. S. 662, 674; 17 Sup. Ct. Rep. 230; Maxwell, *Interpretation of Statutes*, 4th ed., 61-62.

³ *United States v. Three Railroad Cars*, 1 Abb. (U. S.), 196, 210; *Cummings v. Akron Cement, etc. Co.*, 6 Blatchf., 509, 511 (headnote inadequate); *Commonwealth v. Kelley*, 177 Mass., 221; 58 N. E., 691; *Tyrrell v. Mayor, etc. of New York*, 159 N. Y., 239; 53 N. E., 1111; 26 Am. & Eng. Enc. of Law, 2nd ed., 630; Cf. *Ewing v. Burnet*, 11 Pet. 41, 54 (as to the construction of a charge to a jury).

"corporation" is found in the fact that the classes of corporations which are expressly excepted from the operation of the Act,¹ are, most of them, corporations which are not "organized for profit," so that if those words qualify "corporation" as well as "joint stock company or association," the express exceptions become largely surplusage. It would seem that a corporation "organized for profit," is another name for what is often designated as a "business corporation."²

§ 18. How Objects of Company Determined for Purposes of the Act. — In all cases in this Act, as well as elsewhere, where corporations are classified with respect to their objects, or the character of their business, there is apt to be an ambiguity whether the objects of the company and the character of its business are to be determined for purposes of the classification by its ostensible objects and business as defined in its charter or incorporation paper, or by the real objects of its promoters,

¹ See *infra* § 21-§ 26.

² See 1 Machen, *Mod. Law of Corps.*, § 28, where authorities will also be found as to the meaning of "corporations formed for profit." These words would not include a Board of Trade: *People v. Board of Trade*, 80 Ill., 134, 136. But cf. *Mersey Docks v. Lucas*, 8 A. C., 891 (corporation formed for management of public docks, whose revenues were required to be applied to expenses, interest on debt, construction and management, and accumulation of a sinking fund for extinguishment of the principal of the debt, after which extinguishment the rates should be reduced, held assessable for income tax on its "profits").

and by the character of business which they actually carry on.¹ This question repeatedly recurs in the interpretation of the present Act, and is here mentioned once for all. In most cases the objects of a company and the character of its business are to be determined for purposes of the Act by the charter or incorporation paper, rather than by the business which the company actually transacts. Thus, the expression, corporations organized for profit, evidently refers to corporations which by their charters are created for that object, and would not include a corporation formed ostensibly for a different object, but actually operated for purposes of profit. This is made clearer by the expression which is found a few lines below in the same paragraph of the statute, "organized and operated exclusively for religious, charitable, or educational purposes,"² thus drawing a distinction between the purposes for which a corporation is ostensibly "organized," and those for which it is actually "operated."

¹ See 1 Machen, Mod. Law of Corps., § 27. In addition to cases there cited, see in support of the view that the classification of a corporation is to be determined exclusively with reference to its objects as expressed in its charter or incorporation paper, *Speer v. Colbert*, 200 U. S., 130; 26 Sup. Ct., 201; *Bradfield v. Roberts*, 175 U. S., 291; 20 Sup. Ct. Rep. 121; *Colgate v. U. S. Leather Co.*, 72 Atl. 126 (N. J. Eq.); *Webber Hospital Ass'n v. McKenzie*, 71 Atl. 1062 (Me.); *People v. Neff*, 34 N. Y. App., Div. 83 (not exempt from taxation as a charitable corporation, though funds in fact devoted to charity).

² Act, Par. 1, lines 46-48 (*infra* Appx. I).

§ 19. **"Having a Capital Stock Represented by Shares."** — These words,¹ like the words "organized for profit," should be read with "corporation," as well as with "joint stock company or association."² No corporations except such as have a capital stock represented by shares are subject to the Act. In this circumstance lurks a possible method for evading the tax. For, in England, companies sometimes issue stock which is not divided into indivisible shares, but is infinitely subdivisible.³ Although this form of security may not at present be authorized by the statutes of any American State, yet there is nothing to prevent some state legislature from conforming its laws in this respect to the British Companies Acts. A corporation organized under such laws, with stock, in the English sense of the word, and not shares, would not be subject to this federal tax, or be bound to make any returns under the Act; for its capital stock would not be "represented by shares." The device is as simple as it is efficacious.

§ 20. **Insurance Companies.** — Inasmuch as insurance companies would undoubtedly fall within the class of corporations organized for profit,⁴ the

¹ Act, Par. 1, lines 3-4 (*infra* Appx. I).

² The same consideration mentioned above with respect to the words "organized for profit" apply to these words. See *supra* § 17.

³ 1 Machen, *Mod. Law of Corps.*, § 494, § 495. See also *Companies (Consolidation) Act, 1908, Sec. 41.*

⁴ *Hercules Mut. Life Ass. Soc.*, 12 Fed. Cas. 12; *Independent Ins. Co.*, 13 Fed. Cas. 13. Cf. *Equitable Life Ass.*

only effect of expressly mentioning "every insurance company" ¹ is to include mutual companies, which would otherwise be excluded by force of the words, "having a capital stock represented by shares." The meaning of insurance in this connection is perhaps not easy accurately to define.² The days when all insurance could be divided into the three classes of life, fire, and marine, have long since passed; and we are now familiar with burglary insurance, fidelity insurance, guaranty insurance, and indeed still other forms of insurance. Yet, certainly guaranty companies are not usually included within the term "insurance companies"; and the same is true with respect to companies formed for some other kinds of insurance in the broadest meaning of that term. Until the courts have construed this Act, one cannot say whether the word insurance, as therein used, refers to any

Soc. v. Bishop (1900), 1 Q. B. 177; *New York Life Ins. Co. v. Styles*, 14 A. C. 381 (income of mutual insurance company received as premiums from members not assessable as profits); *Last v. London Ass. Co.*, 10 A. C., 438 (*secus* as to income derived from premiums on participating policies issued by a joint stock insurance company).

¹ Act, Par. 1, line 4 (*infra* Appx. I).

² For judicial definitions of "insurance" and "insurance companies," see those titles in 4 Words and Phrases Judicially Defined, pp. 3674, 3679, and also 22 Cyc, 1384, tit. "Insurance." A corporation which for a membership fee agrees to clean a member's bicycle, repair the machine, and replace it if stolen, is not to be incorporated as an "insurance company": *Commonwealth v. Provident Bicycle Ass'n*, 178 Pa. 636; 36 L. R. A. 589; 36 Atl. 197.

contract whereby money is to be paid to a person upon the occurrence of a specified form of loss or disaster, so that "insurance companies" would include any company engaged in the business of making any kind of such contracts, or whether the expression is used in a narrower and more popular sense.

The question is not important in construing the words in this paragraph of the Act, because the great majority of such companies (with the exception of mutual companies for insurance upon life and against fire, which are indisputably embraced within the heading of insurance companies) are formed upon the ordinary joint stock plan, and would therefore be embraced by the words "corporations . . . organized for profit and having a capital represented by shares," so that it becomes unnecessary to determine whether they would also be subject to the Act as insurance companies. The same question, however, will recur, because certain special allowances are permitted to "insurance companies" in calculating their net income for purposes of the tax.¹

§ 21. Expressly Excepted Classes of Companies — In General. — The express exceptions of certain classes of organizations from the operation of the Act² would seem to have been inserted out of abundant caution. Few of the excepted classes of organizations are ever formed upon the joint stock

¹ See *infra*, § 58, § 59.

² Act, Par. 1, lines 34–50 (*infra* Appx. I).

plan, and almost none of them could be regarded as "organized for profit," or as having any "business," with respect to the carrying on or doing of which the tax is expressed to be levied. The chief effect, therefore, of the insertion of these express exceptions is to becloud the interpretation of the Act, and to cause some doubt whether the words "organized for profit and having a capital stock represented by shares" should not be held to qualify merely the words "joint stock company or association," and not the preceding word, "corporation."¹

§ 22. "Labor Organizations." — It seems that this exception² was intended in favor of trade-unions, and similar organizations of laboring men for the purpose of promoting the welfare of their class.³ As a rule, they could not be said to be "organized for profit"; and they certainly rarely or never have a "capital stock represented by shares." Hence if only such corporations as are organized for profit with a capital stock divided into shares are subject to the Act, the express exception of labor organizations seems quite unnecessary.

§ 23. "Agricultural or Horticultural Organiza-

¹ See *supra*, § 17.

² Act, Par. 1, lines 36-37 (*infra* Appx. I).

³ See 18 Am. & Eng. Enc. of Law, 2nd ed., 80-81, tit. "Labor Organizations"; 24 CYC. 816-817. In neither place are any references given to any judicial decisions on the point, which seem to be wholly lacking.

tions." — These words ¹ are probably intended to exclude from the operation of the Act any organization of farmers for the purpose of mutual consultation and assistance.² Perhaps, also, they have the effect of exempting corporations formed for the purpose of promoting agriculture by means of county fairs, and the like. The collocation with labor organizations would seem to indicate that Congress had in mind organizations of farmers and horticulturists similar in character to labor organizations.

§ 24. **Fraternal Beneficiary Societies Operating under the Lodge System, and Providing for the Payment of Life, Sick, Accident, and other Benefits to Members or Dependents of Members.** — The classes of corporations here intended ³ are designated with clearness;⁴ but as they are never formed with a capital stock, they would not, even without the express exception, be subject to the Act, unless the narrower application of the words "having a capital stock represented by shares" is the true meaning.

¹ Act, Par. 1, lines 36–37 (infra Appx. I).

² For judicial definitions of an agricultural society, see 1 Words and Phrases Judicially Defined, 288, tit., "Agricultural Societies."

³ Act, Par. 1, lines 37–43 (infra Appx. I).

⁴ Cf. *National Union v. Marlow*, 74 Fed. 775; 21 C. C. A. 89; 13 Am. & Eng. Enc. of Law, 2nd ed., 1043–1045, tit. "Benevolent or Beneficial Associations"; Bacon on Benefit Societies, 3rd ed., § 1 *et seq.*; 29 CYC. 7–11, tit., "Mutual Benefit Insurance"; 1 Words and Phrases Judicially Defined, 748, tit. "Beneficial Associations."

§ 25. **Building and Loan Associations.** — Only “domestic” building and loan associations are expressly excepted.¹ That word is evidently used, not as opposed to “foreign,” but as confining the exception to such associations as have for their chief, if not their only, object, the lending of money for the purpose of enabling the borrower to acquire a home. The meaning of the words, “building and loan associations,” is sufficiently well understood in the law as to call for no comment.² In order, however, to be within the express exception, a building and loan association must be organized and operated exclusively for the mutual benefit of members.

§ 26. **Religious, Charitable, or Educational Corporations.** — In order to be within this exception,³ it is necessary that a corporation be organized *exclusively* for the purposes mentioned. No such corporation could be regarded as “organized for profit”; and few such corporations have a capital stock. The necessity of the express exception is, therefore, not easy to see. However, it perhaps removes a doubt—probably unfounded,⁴ —

¹ Act, Par. 1, lines 43–45 (infra Appx. I).

² For definitions see 6 CYC. 120. tit. “Building and Loan Societies.”

³ Act, Par. 1, lines 46–50:

⁴ See *McLeod v. Lincoln Medical College*, (Neb), 96 N. W., 265, 266; *Santa Clara Female Academy v. Sullivan*, 116 Ill., 375, 387–388; 6 N. E. 183; 56 Am. Rep. 776; *McDonald v. Mass. Gen. Hospital* 120 Mass. 432; 21 Am. Rep. 529

whether an educational corporation is converted into a business corporation merely because it makes a charge for tuition. "Charitable" in such a connection is not used in the popular meaning of relief from poverty, but in the broader signification it has acquired in English law.¹ A religious corporation is one formed for the purpose of worshipping God, and propagating the faith.²

§ 27. **Line of Demarkation between Foreign Companies and Domestic Companies.** — The line drawn in the Act between foreign and domestic companies is between companies "organized under the laws of any foreign country" on the one hand,³ and companies "organized under the laws of the United States, or of any State or Territory of the

(hospital requiring its patients to pay for their board); *Rex v. Special Commissioners*, 98 L. T. 446.

¹ *Commissioners for Income Tax v. Pemsel* (1891), A. C. 531; *Rex v. Special Commissioners*, 98 L. T. 446. As to what are charitable purposes, see further, *St. Andrew's Hospital v. Shearsmith*, 19 Q. B. D. 624; *Paddington Burial Board v. Commissioners of Inland Revenue*, 13 Q. B. D. 9; *People v. Neff*, 34 N. Y. App. Div. 83; 12 Am. & Eng. Enc. of Law, 2nd ed., 337, tit., "Exemptions from Taxation"; 2 Words and Phrases Judicially Defined, 1074, *et seq.*, titles, "Charitable Institutions" and "Charity"; *Grove v. Young Men's Christian Ass'n*, 88 L. T. 696 (Y. M. C. A. maintaining a restaurant liable to tax on profits thereof).

² *Baltzell v. Church Home and Infirmary*, 73 Atl. 151; 110 Md. 244. See also 7 Words and Phrases Judicially Defined, 6063-6068, titles, "Religion" to "Religious Worship," inclusive.

³ Act, Par. 1, lines 9-10 (*infra* Appx. I).

United States, or under the Acts of Congress applicable to Alaska or the District of Columbia," on the other hand.¹ Do these two classes together embrace all conceivable companies, or may there be a *tertium quid*, which is included in neither? It is clear that a corporation formed under the laws of Porto Rico, or of the Philippine Islands, is not "organized under the laws of any foreign country";² but on the other hand, is it within the class of domestic companies as defined in the Act? The express mention of Alaska and the District of Columbia would seem by inference at least to exclude the Insular Possessions,³ and indeed they can hardly be regarded as "territories" of the United States.

The same question as to the meaning of the words, "the United States and its Territories, Alaska and the District of Columbia," which are

¹ Act, Par. 1, lines 5-8 (*infra* Appx. I).

² *Dooley v. United States*, 182 U. S. 222; 21 Sup. Ct. Rep. 762; *DeLima v. Bidwell*, 182 U. S. 1; 21 Sup. Ct. Rep. 743; *Ponce v. Roman Catholic Church*, 210 U. S. 296, 309; *Dooley v. United States*, 183 U. S. 151; 22 Sup. Ct. Rep. 62; *Fourteen Diamond Rings*, 183 U. S. 176; 22 Sup. Ct. Rep. 59; *Lincoln v. United States*, 197 U. S. 419; 25 Sup. Ct. Rep. 455.

³ The first section of the Act of Aug. 5, 1909, c. 6, of which the corporation tax provisions constitute the thirty-eighth section, refers to articles "imported from any foreign country into the United States, or any of its possessions, except the Philippine Islands, and the Islands of Guam and Tutuila." Section 5 refers to "articles coming into the United States from the Philippine Islands."

frequently repeated,¹ will constantly recur. It is now mentioned once for all, and will not again be referred to.

§ 28. What is "Engaged in Business in the United States." — No foreign company is subject to the tax unless it is "engaged in business" in the United States, including the territories, Alaska and the District of Columbia;² it is not enough that it may have "capital invested" in this country,³ although if it be doing business, the Act purports to tax it upon the income derived from capital invested in the United States, as well as from business transacted therein. The meaning of these words, "engaged in business," is almost certainly the same as that of the words, "doing or carrying on business," in statutes regulating service of process on foreign corporations doing business in a state,⁴ or prohibiting foreign corporations from doing business in the state, except upon compliance with certain conditions. Although there is some conflict of authority as to the construction of such statutes, yet in the main there is a substantial agreement between the various

¹ Act, Par. 1, lines 28-30; Par. 2, lines 48-50, 53-55, 60-62, 77-79; Par. 3, lines 48-50, 68-70, 84-86, 112-114. Compare also the expression, "of the United States or of any state or territory thereof." Act, Par. 2, lines 32-34, 83-84.

² Act, Par. 1, lines 10-12 (Appx. I).

³ Cf. *People v. Campbell*, 138 N. Y. 543, 546; 34 N. E. 370; 20 L. R. A. 453; *People v. Am. Bell Tel. Co.*, 117 N. Y. 241; 22 N. E. 1057.

⁴ Cf. *Mutual Life Ins. Co. v. Speatley*, 172 U. S. 602.

courts of this country.¹ It must be remembered, however, that inasmuch as the federal courts follow the state courts as to the construction to be given to the words "doing business within the state" in a state statute,² decisions of the federal courts construing those words in a state statute must not too readily be accepted as controlling authority as to the construction of this Act of Congress. Almost precisely the same question that arises under this statute has come up in England under a statute subjecting to income tax any person who 'exercises a trade' in the United Kingdom.³

¹ When the facts are disputed, the question must, of course, in actions at law, be left to the jury, under proper instructions by the Court: *Audenried v. East Coast Milling Co.*, 124 Fed. 697; *Oakland Sugar Mill Co. v. Wolf Co.*, 118 Fed. 239; 55 C. C. A. 193.

² *Erie Ry. Co. v. Pennsylvania*, 21 Wall. 492, 497 (head-note inadequate).

³ *Grainger v. Gough* (1896), A. C. 325; *Lovell & Christmas v. Commissioner of Taxes* (1908), A. C. 46 (as to a similar New Zealand statute, the court saying: "The trade or business in question in such cases ordinarily consists in making certain classes of contracts and in carrying those contracts into operation with a view to profit, and the rule seems to be that where such contracts, forming as they do the essence of the business or trade, are habitually made, there a trade or business is carried on within the meaning of the Income Tax Acts, so as to render the profits liable to income tax."). *Watson v. Sandie* (1898), 1 Q. B. 326 (goods sold in his own name by agent for foreign principal, who was held liable to income tax on the profits of the transaction as exercising a trade in the United Kingdom); *Werle & Co. v. Colquhoun*, 20 Q. B. D. 753; *Pommery v. Apthorpe*, 56 L. J.

A mere isolated transaction is not doing business within the state: there must be some course of action, or repeated action within the state, in order to constitute doing business.¹ The mere ownership of property within the state is certainly not doing business.² So it would seem clear that the acquisition of property in the state, as an investment, is not doing business.³ Mere soliciting

Q. B. 155 (French wine merchant held to be taxable as exercising a trade in England); *Tischler v. Apthorpe*, 52 L. T. N. S. 814 (a similar decision to last case).

¹ *Cooper Mfg. Co. v. Ferguson*, 113 U. S. 727; 5 Sup. Ct. Rep. 739; *Empire Milling, etc., Co. v. Tombstone Mill, etc., Co.*, 100 Fed. 910 (simple contract to pay a third person for exploiting and developing land owned by the company within the state not doing business); *Frawley, Bundy & Wilcox v. Pennsylvania Casualty Co.*, 124 Fed. 259 (writing four policies in the state for residents thereof, and collecting a single premium through a bank therein, not doing business by an insurance company); *Clews v. Woodstock Iron Co.*, 44 Fed. 31 (executing mortgage, and procuring listing of its securities on the stock exchange); *St. Louis Wire-Mill Co.*, 32 Fed. 802 (occasional purchases of material); *Good Hope Co. v. Railway Barb Fencing Co.*, 22 Fed. 635 (president going into state to adjust controversy growing out of occasional purchases of materials); *Grainger v. Gough* (1896), A. C. 325, 343 (per Lord Morris, in respect to liability to income tax).

² *Empire Milling, etc., Co. v. Tombstone Mill, etc., Co.*, 100 Fed. 910 (stated supra); *United States v. Am. Bell Tel. Co.*, 29 Fed. 17.

³ *Sullivan v. Sheehan*, 89 Fed. 247 (lending money on security of property in the state not doing business therein); *Caesar v. Capell*, 83 Fed. 403 (similar point); *Eastern Bldg. Ass'n. v. Bedford*, 88 Fed. 7 (similar point); *Gilchrist v. Helena, etc., R. Co.*, 47 Fed. 593 (foreign trust company pur-

of contracts by travelling agents has been held not to be doing business.¹ Making of contracts by correspondence with a resident of a state and relating to property therein is not doing business in that state.² On the other hand, it seems that the collection of premiums upon policies previously written in the state amounts to doing business therein.³ Maintenance of ticket-office by a railway company, especially when coupled with the running of through trains over the tracks of another company, is doing business.⁴ When a company by a chasing mortgage bonds of domestic railway, and acting as trustee of the mortgage).

But see *Santa Clara Female Academy v. Sullivan*, 116 Ill. 375, 384; 6 N. E. 183; 56 Am. Rep. 776 (semble).

¹ *Boardman v. McClure Co.*, 123 Fed. 614; *Davis & Rankin etc. Co. v. Dix*, 64 Fed. 406 (sales through travelling salesmen); *Grainger v. Gough* (1896), A. C. 325 (foreign wine-merchant not liable to income tax as exercising a trade in the United Kingdom where an agent solicits orders which are transmitted to the principal's foreign residence and there accepted — a decision with which *Werle & Co. v. Colquhoun*, 20 Q. B. D. 753, should be compared).

But see *Turner v. Evans*, 2 E. & B. 512 (wine merchant systematically soliciting orders in a certain county held to have violated a contract not to carry on business therein); *Brampton v. Beddoes*, 13 C. B. N. S. 538 (a similar decision, where defendant had sold to customers within the prohibited territory at their own solicitation).

² *Hazeltine v. Mississippi Val. Fire Ins. Co.*, 55 Fed. 743.

³ *Mutual Life Ins. Co. v. Spratly*, 172 U. S. 602. But see *Frawley, Bundy & Wilcox v. Pennsylvania Casualty Co.*, 124 Fed. 259 (stated supra).

⁴ *Norton v. Atchison etc. R. Co.*, 61 Fed. 618; *Van Dresser v. Oregon Ry. etc. Co.*, 48 Fed. 202.

salaried representative in New Zealand solicited and obtained consignments of goods to it in London to be sold on commission, it was held that no business was transacted in New Zealand, or that at all events, the profits made as commission on the sales in London could not be deemed to have arisen from business carried on in New Zealand.¹

But for a full discussion of this question, the reader is referred to treatises on the law of foreign corporations.²

§ 29. Corporations Organized or Dissolved within the Year, etc. — The First Paragraph of the Act imposes the tax on all domestic corporations and companies of the classes specified, “now or hereafter organized,”³ and on foreign companies “now or hereafter organized and engaged in business” in the United States.⁴ It would seem therefore that a corporation which had been dissolved before the Act took effect, — that is, before August 5th, 1909,⁵ — would not be subject to tax, even though it might have transacted some business, and earned some income prior to that date.⁶ So, too, a foreign company which had ceased to do business in this country before August 5th,

¹ *Lovell & Christmas v. Commissioner of Taxes* (1908), A. C. 46.

² Beale on Foreign Corps., § 204—§ 209.

³ Act, Par. 1, lines 4–5 (*infra* Appx. I).

⁴ Act, Par. 1, lines 10–12 (*infra* Appx. I).

⁵ See Act, § 42 (*infra* Appx. I).

⁶ It is to be observed that by § 42 of the Act (*infra* Appx. I)

1909, would escape all the burdens of the Act. On the other hand, if a domestic corporation is in existence for even a day after August 5th, 1909, or if a foreign company does business in this country for even a day after that date, perhaps it becomes liable to the tax imposed on its net income for the entire year 1909,¹ and cannot escape the tax by dissolving, or ceasing to do business before the end of the year.² On the other hand, the Act furnishes no machinery for assessment of the tax against dissolved corporations. For instance, a dissolved corporation can have no chief officer and no treasurer or assistant treasurer; and without such officers, who is to make the it is expressly provided that the "Act shall take effect on the day following its passage."

Note, however, that by Rev. Stats. § 5 (1 U. S. Comp. Stats. p. 4), the word "company" or "association," when used in an Act of Congress in reference to a corporation, shall be deemed to embrace the words "successors and assigns of such company or association," in like manner as if these last-named words, or words of similar import, were expressed.

¹ But see *Spreckels Sugar Ref. Co. v. McClain*, 109 Fed., 76, 79, reversed on other points, 113 Fed. 244; 192 U. S. 397; *Commonwealth v. Lancaster Sav. Bank*, 123 Mass. 493 (banking corporation which is in hands of receiver and perpetually enjoined from transacting business on November 1st not liable to a franchise or business tax for the preceding six months, measured by its average deposits during that period, although it had transacted business within that term).

² Cf. *Mandell v. Pierce*, 3 Cliff. 135 (as to the liability of an executor for income tax, when the testator dies within the year). As to the constitutionality of this feature of the Act, see *infra* § 148. See also *infra* § 39.

return on its behalf? And without a return, how is the tax to be assessed? For it would seem difficult to hold that a corporation which had ceased to exist, and therefore *could* not make the return, is to be treated as in default for not doing so; and unless it is in default, the Commissioner of Internal Revenue has no authority to prepare a return on its behalf.

Corporations which are organized after the Act goes into effect, and within the year, and foreign companies which within that period begin business in this country, are clearly subject to the tax.

The Commissioner of Internal Revenue has ruled that, "Corporations organized during the year, or going into liquidation during the year, should nevertheless render a sworn return on the prescribed form." ¹

¹ U. S. Int. Rev. Regs., No. 31, Dec. 3rd, 1909 (Infra Appx. II).

CHAPTER IV

HOW THE TAXABLE INCOME IS CALCULATED

- § 30 In general.
- § 31 Income distinguished from profits.
- § 32 Statutory provisions as to method of calculation mandatory.
- §§ 33-44A What to be included as " the gross amount of the income."
- § 33 In general.
- § 34 Dividends on stock held in other companies.
- § 35 Increase in value of property — sale of capital sets.
- § 36 Purchase price payable by instalments.
- § 37 Force of the word " received " in " gross amount of income received " in Paragraph 2 of the Act.
- § 38 Income received as trustee.
- § 39 Income received before passage of the Act.
- § 40 Income derived from property exempt from taxation.
- § 41 Income derived from land.
- § 42 Income from invested personal property.
- § 43 What is income from business as distinguished from investments.
- § 44 Income from *ultra vires* business.
- § 44A Income from foreign business and property.
- §§ 45-74 Deductions to be made from gross income.
- § 45 Is statutory list of deductions exhaustive?
- §§ 46-52 Maintenance and operation.
- § 46 The provision in general.
- § 47 What is maintenance and operation, — in general.
- § 48 Maintenance of property.

- § 49 Expenses "actually paid" — meaning of the expression.
- § 50 Necessity that expenses should have been paid "out of income" in order to be deducted.
- § 51 Meaning of "ordinary and necessary" expenses.
- § 52 Charges such as rentals and franchise payments.
- §§ 53-59 Deductions for losses.
- § 53 Necessity for an express provision of law allowing such deductions.
- § 54 Meaning of "losses."
- § 55 Loss must be "sustained within the year."
- § 56 Must be "not compensated by insurance or otherwise."
- § 57 Depreciation of property.
- §§ 58-59 Deductions by insurance companies.
- § 58 "Sums other than dividends paid with the year on policy and annuity contracts."
- § 59 Additions to reserve funds.
- §§ 60-67 Deductions for indebtedness or interest thereon.
- § 60 The provision in general.
- § 61 Limitation on amount of indebtedness — what is "the paid-up capital stock."
- § 62 As of what date amount of capital stock and of indebtedness is to be taken.
- § 63 Force of the word "Outstanding" in capital stock outstanding at the close of the year.
- § 64 Indebtedness of non-stock corporations.
- § 65 Indebtedness in excess of the paid-up capital.
- § 66 Money used in paying principal of debts — Monies added to sinking funds.
- § 67 Interest on bank deposits.
- §§ 68-70 Deductions for taxes.
- § 68 In general.
- § 69 Special assessments for betterments.
- § 70 Foreign taxes.
- §§ 71-74 Dividends on shares in other companies.
- § 71 In general.

- § 72 On shares in companies whose net income is less than five thousand dollars.
- § 73 On shares in foreign companies.
- § 74 Meaning of "Dividends" in this connection.
- §§ 75-84 Method of calculating taxable income of foreign companies.
- § 75 In general.
- § 76 Gross income "from business transacted and capital invested in the United States."
- § 77 How to apportion profits between that part of business transacted in the United States and that part transacted abroad.
- § 78 What is income from "capital invested in the United States."
- §§ 79-84 Deductions from gross income by foreign companies.
- § 79 In general.
- § 80 Operating expenses of foreign companies.
- § 81 Losses by foreign companies.
- § 82 Interest on indebtedness paid by foreign companies.
- § 83 Taxes paid by foreign companies.
- § 84 Dividends on shares in other companies held by foreign companies.
- § 84A For what period income is calculated.

§ 30. **In General.** — Inasmuch as the tax is either a tax upon income or at any rate is graduated with reference to income, it is next pertinent to inquire how the income is to be calculated for the purposes of the tax. The Act of Congress contains full, though perhaps not exhaustive nor exclusive, directions as to the method to be followed in this process of calculation.

§ 31. **Income Distinguished from Profits.** — The

matter to be ascertained by this process is net income, not profits. The two terms are not synonymous.¹ For instance, where the company's fixed capital² has increased in value, the increment may be regarded as profits and may be distributed as dividends;³ but it is not income and would not be liable to tax under the present law.⁴ Even if there were no directions in the Act as to the mode of ascertaining profits, this would be true. *A fortiori* the mere fact that the company's assets may exceed in value the sum of its liabilities and outstanding paid-up capital, although the excess is deemed profits and as such is distributable as dividends, has no tendency to show the existence of "net income" in proportion to which this tax is

¹ It is submitted that the Commissioner of Internal Revenue is mistaken in his statement that "gross income is practically the same as gross profits, the only difference being that gross income is more inclusive, embracing as it does not only gross profits of the corporation, joint stock company and association itself, but also all amounts of income received from all other sources." U. S. Int. Rev. Regs. No. 31, Dec. 3d, 1909, Art. 2, § 5 (Infra Appx. II). So, "earnings" is not synonymous with "profits"; *Grant v. Hartford, etc., R. R. Co.*, 93 U. S. 225, 228.

² As to the meaning of "fixed capital," see 2 Machen Mod. Law of Corps., § 1323.

³ 2 Machen, Mod. Law of Corps., § 1314, § 1320.

⁴ *Gray v. Darlington*, 15 Wall. 63, 66 ("Mere advance in value in no sense constitutes the gains, profits or income specified by the statute. It constitutes and can be treated merely as an increase of capital").

Cf. infra § 35.

assessed. In other words, in order to ascertain the amount of net income for purposes of the tax, the so-called single-account or balance-sheet method of ascertaining the amount of profits available for dividends ¹ must be rejected, and in lieu thereof something resembling the double-account method of calculating profits ² must be adopted. The Act of Congress recognizes this fact, and the method prescribed in Paragraph 2 of the Act for ascertaining net income will be found to follow the general plan of the so-called double-account method of ascertaining profits.

§ 32. **Statutory Provisions as to Method of Calculation Mandatory.** — The Second Paragraph of the Act prescribes the method of calculating net income for purposes of the tax. These statutory regulations are evidently, so far as they go, mandatory. The language is, "Such net income *shall be* ascertained" by the method particularly set out in the statute. The statutory rules may not be exhaustive, but they are certainly obligatory and not merely directory. There are certain differences between the rules applicable to domestic companies and those prescribed for foreign companies. These differences spring from the fact that in the case of domestic companies the entire net income in excess of five thousand dollars is

¹ As to this method, see 2 Machen, Mod. Law of Corps., § 1314-§ 1319.

² As to this method, see 2 Machen, Mod. Law of Corps., § 1320-§ 1337.

taxed, while in the case of foreign companies it is only so much thereof as is derived from business transacted and capital invested in this country. It will, therefore, be simplest to discuss the method of calculating net profits in the case of domestic companies, and afterwards to consider the peculiar questions arising with respect to the similar calculation in the case of foreign companies.

§ 33. **What is "the Gross Amount of the Income."** — **In General.** — Congress has provided that the net income shall be ascertained by making certain deductions from "the gross amount of the income."¹ The first question is, what is gross income. Upon this point the Act is silent, so that resort must be had to the general principles of law. Income means primarily that which comes in,² and gross income is therefore the gross amount which is received by the company during the year, without deduction for the outlay necessary to bring it in. For a further statement of what income is, reference must be made to the treatises on the general law of corporations.³ In the absence of affirmative statutory authority an assessment for income tax must not include the rental value of premises owned and actually occupied by the taxpayer,

¹ Act, Par. 2, lines 1-3 (infra Appx. I).

² For full citation of authorities defining "income," see 22 CYC. 63 et seq., tit. "Income." Cf. also *Re Redding* (1897), 1 Ch. 876; *Lawless v. Sullivan*, 6 A. C. 373.

³ See particularly, 2 Machen, *Mod. Law of Corps.*, § 1330, § 1334-§ 1336.

or even of premises which he is permitted to occupy rent free.¹ The mere fact that a remittance to the company from an agent is described, or, as Lord Halsbury said, nicknamed, a return of capital is obviously not conclusive, and it seems is not even sufficient to relieve the company of the burden of proving how much, if any, of the sum so received is capital.² As Lord Halsbury put it, the company virtually say to their agents, “ ‘ Whenever you send money to this country, do not find out what in strictness is the difference between capital and income, but describe whatever you send back to us as repayment of capital — take care you do not describe it as interest.’ ”³

§ 34. **Dividends on Stock Held in Other Companies.** — Dividends on stock of other companies held by the tax-paying company may or may not be income; this question often arises as between a tenant for life and a remainderman, where shares are held in trust,⁴ and it would seem that no dividend should be held to be taxable as income of a shareholding company unless it would be payable to a tenant for life of the shares.⁵ In

¹ *Tennant v. Smith* (1892), A. C. 150.

² *Scottish Provident Ass'n v. Allan* (1903), A. C. 129.

³ (1903), A. C. 135.

⁴ See 2 Machen, *Mod. Law of Corps.*, § 1377–§1396.

⁵ Cf. *Merchants' Ins. Co. v. McCartney*, 1 Lowell 447 (holding that so much of a dividend as represented profits earned before the income-tax law went into effect was not taxable as income of the holding company; but to be com-

connection with the present Act, the question cannot arise except where a domestic company holds stock in a foreign company, for all dividends on stock of domestic companies are exempt.¹ The fact that a domestic company owns shares, even all the shares, of a foreign company does not make the business of the foreign company the business of the domestic company, so as to subject the domestic company to tax on the income of the foreign company unless it be used to declare and pay a dividend.² The Act, contemplates, however, that dividends on the stock of all other companies — at any rate such dividends as amount to income rather than capital — shall be returned as part of the gross income although they are to be off-set, in the case of other companies which are subject to the tax, by a credit or deduction of an equal amount.³

§ 35. Increase in Value of Property. — Sale of Capital Assets. — It has been shown above that

pared with *Gibbons v. Mahon*, 136 U. S. 549; 10 Sup. Ct. 1057; *Reynolds v. Williams*, 4 Biss. 108 (a somewhat similar case in principle to *Merchants' Ins. Co. v. McCartney*, *ubi supra*).

¹ Cf. *infra* § 71, et seq.

² *Gramophone & Typewriter v. Stanley* (1908), 2 K. B. 89; *Kodak, Ltd. v. Clark* (1903), 1 K. B. 505. See also 2 Machen, *Mod. Law of Corps.*, § 1080.

But see *American Sugar Ref. Co. v. Rutan*, 123 Fed. 979; *Apthorpe v. Peter Schoenhofen Brewing Co.*, 80 L. T. 395; *St. Louis Breweries v. Apthorpe*, 79 L. T. 551.

³ See *infra* § 71-§ 74.

an increase in the value of a company's fixed capital is not to be regarded as income for the purpose of the Act.¹ But what if the capital is actually sold during the year? On principle, it is difficult to see why that fact should make any difference, or should convert any part of the proceeds of sale, representing fixed capital sold, into income. Of course, a sale of circulating capital — capital which is acquired for the purpose of making a profit by a sale thereof — would stand on a wholly different footing; for in such a case the difference between the purchasing price and the selling price is undoubtedly income. But where a company for reasons of convenience, or for liquidation, or for any other reason, makes a sale of fixed capital, the case is wholly different. For example, suppose a mercantile company should desire to move its store from one location to another, and with that object in view should sell its old store. It is submitted that in such a case the fact that a good price may be realized — more than the company paid for the property, or more than it was worth at the beginning of the year, — is no reason whatever for treating that excess as income.²

Nevertheless, the Commissioner of Internal Revenue in his regulations recently promulgated has laid down the rule broadly that in the case of a sale of capital assets, the excess of the selling

¹ Supra § 31.

² Gray v. Darlington, 15 Wall. 63. But see United States v. Smith, 1 Sawy. 277.

price over the value at the beginning of the year, or, if the property was bought after the beginning of the year, over the buying price, is to be treated as income.¹ It would seem, however, that for the reasons just indicated, this ruling disregards the distinction between different kinds of capital, and ought to be revised by the Commissioner. It is also believed that if the question shall be taken to court, this ruling, if it shall be adhered to by the Commissioner, would be reversed; for he seems to have overlooked an express decision of the Supreme Court.²

§ 36. **Purchase Price Payable by Instalments.** — Under the British income-tax statutes, the courts will, in any case of a sale, or ostensible sale, of capital assets, where the purchase price is payable by instalments, look through the form of the transaction and ascertain how much of each instalment is in substance interest and therefore liable to income tax, and how much is in substance a mere deferred payment of principal and as such free of tax.³ In one case of an ostensible purchase of a lease by a sub-lessee, it was even held that the full amount of the deferred payments represented, in substance, rent reserved on the sub-lease and

¹ U. S. Int. Rev. Regs. No. 31, Dec. 3d, 1909, Art. 2, § 5 (infra Appx. II).

² *Gray v. Darlington*, 15 Wall. 63.

³ *East Indian Ry. Co. v. Secretary of State* (1905), 2 K. B. 413; *Secretary of State v. Scoble* (1903), A. C. 299. Cf. *Foley v. Fletcher*, 3 H. & N. 769 (income tax held not payable on the deferred instalments).

was therefore liable to tax.¹ The phraseology of the British statutes, on which these cases turn, is very different from that of the Act of Congress; but nevertheless our courts would probably, like the English courts, look through the form of the transaction, and apply the same or a similar distinction between interest, or income, and deferred payments of principal.

§ 37. Force of Word "Received" in "Gross Amount of Income Received" in Paragraph 2 of the Act. — It should be observed that the tax is proportioned to income "*received*"² during the year. This word would seem to exclude income to which the company may be entitled but which has not been collected.³ Perhaps, it would be too

¹ *Chadwick v. Pearl Life Ins. Co.* (1905), 2 K. B. 507. Cf. *Delage v. Nugget Polish Co.*, 92 L. T. 682.

² Act, Par. 1, line 19; Par. 2, line 5; Par. 3, line 43 (*infra* Appx. I). As to the force of this word in an income-tax law, see *Gresham Life Ass. Soc. v. Bishop* (1902), A. C. 287; *Colquhoun v. Brooks*, 14 A. C. 493; *Bartholomay Brewing Co. v. Wyatt* (1893), 2 Q. B. 499; *Scottish Provident Inst. v. Allan* (1903), A. C. 129. This word "received" was not contained in the Income-Tax Law of 1862 and, therefore, *Magee v. Denton*, 5 Blatchf. 130, which was decided under that statute, is distinguishable. Cf. *United States v. Schilling*, 14 Blatchf. 71 (promissory note not yet mature not taxable as income, the court saying, "In the absence of any special provision of law to the contrary income must be taken to mean money"); *United States v. Smith*, 1 Sawy. 277; *United States v. Frost*, 25 Fed. Cas. 1221 (debts not believed to be good not returnable as income, — a decision to be compared with *United States v. Mayer*, Deady 127).

³ Cf. 2 Machen, *Mod. Law of Corps.*, § 1335.

broad a statement that the Act contemplates only income collected in cash; but at any rate it does seem to distinguish between estimated income and actual receipts. An analogous construction has been given to a regulation that dividends shall be payable only out of "realised profits."¹

In an English case, in overruling a contention that income had been "constructively" received for purposes of income tax by an entry in the company's books without actual transmission of money, Lord Brampton said, "I confess I do not like that expression, nor do I quite understand what it means. If a 'constructive' receipt is the same thing as an actual receipt, I see no reason for the use of the word 'constructive' at all. If it means something different from or short of actual receipt, then it seems to me that a constructive receipt is not recognized by the statute, which in using the word 'received' alone, must be taken to have used it having regard to its ordinary acceptation."² It would seem that the Commissioner of Internal Revenue has overlooked the force of this word "received" in his promulgated regulations wherein he declares that, "It is immaterial whether any item of gross income is evidenced by cash receipts during the year or in such other manner as to entitle it to proper entry on the books of the corporation from January 1

¹ 2 Machen, Mod. Law of Corps., § 1343.

² Gresham Life Ass. Soc. v. Bishop (1902), A. C. 287, 294.

to December 31 for the year in which the return is made.”¹

§ 38. **Income Received as Trustee.** — An important question is whether income received by the company as trustee must be included. The general principle is incontrovertible that in the absence of express provision to the contrary, a trustee is to be regarded for purposes of taxation as though he were the absolute owner of the property,² as indeed he is in a court of law. The trust relation is a matter between him and his cestuis que trust: as between himself and the government he is the absolute owner of the property. There is no provision in the Act of Congress expressly excluding the application of this principle, and yet if it is to be applied the consequences would be so unjust as perhaps to affect the constitutionality of the law.

Take the case of a trust company receiving on

¹ U. S. Int. Rev. Regs., No. 31, Dec. 3d, 1909, Art. 2, § 5 (infra Appx. II).

² *Latrobe v. Mayor etc. of Baltimore*, 19 Md. 13; *Richardson v. Boston*, 148 Mass. 508; 20 N. E. 166; *Anthony v. Caswell*, 15 R. I. 159, 161; 1 Atl. 290; *Greene v. Mumford*, 4 R. I. 313, 319-320; *Mackay v. San Francisco*, 128 Cal. 678; 61 Pac. 382; *Detroit v. Lewis*, 109 Mich. 155; 66 N. W. 958; 32 L. R. A. 439; *Guthrie v. Pittsburgh etc. Ry. Co.*, 158 Pa. 433; *State v. Willard*, 77 Minn. 190, 195; 79 N. W. 829; *City of Lexington v. Fishback's Trustee*, 60 S. W. 727; 22 Ky. Law Rep. 1392; *Cooley on Taxation*, 3d ed., 660.

But see *People v. Coleman*, 119 N. Y. 137; 23 N. E. 488; 7 L. R. A. 407; *Borough of Carlisle v. Marshall*, 36 Pa. St. 397.

behalf of trust estates thousands or even millions of dollars each year. Is all of this income taxable as income of the trustee? If so, of course the company has a right to be reimbursed out of the trust property in its hands, and the result would be that every person whose estate is in the hands of a corporate trustee would be obliged to pay an income tax to the United States, on the whole amount of his income, although individuals who hold the legal title to their property, and also persons whose property is in the hands of individual trustees, pay no similar tax. It may be said, indeed, that this injustice is but little if any greater than the injustice which results inevitably from the ordinary operation of the law; for a person who is so unfortunate as to have his property invested in shares of stock in corporations must pay an income tax while a person who has an equal or greater amount in real estate or other forms of personal property goes entirely free.

The only specific clause in the Act which can be seized upon to exempt income received by corporations as trustees is the statement that the tax is laid "with respect to the carrying on or doing business."¹ Now, obviously the business of a trust company is acting as trustee, but the amount of its income from its business is not fairly measured by the amount of income collected for its *cestuis que trust*, but by the amount of its commissions. Possibly, therefore, an intent can be

¹ Act, Par. 1, lines 14-15 (*infra* Appx. I).

spelled out to exempt income collected as trustee, and to include only income derived from the business of acting as trustee; and so the courts may, it is believed, be confidently relied on to decide. Certainly, if income received as trustee is to be included in making the assessment, that fact is persuasive to show that the tax is laid but colorably on the business, the real intent being to tax incomes.

§ 39. **Income Received before Passage of Act.** — It would appear that the Act intends to tax income received in the year 1909 prior to its passage on August 5th of that year;¹ but in regard to a similar point as to the excise tax of 1898 on gross receipts from sugar refining, it was held that receipts prior to the passage of the Act were not to be included.² The question is, therefore, worth considering.³ If the Act is to be construed as prospective merely, the words "the year," which are constantly recurring in the Act,⁴ must, as applied to the year ending December 31st, 1909, be construed to mean so much thereof as has elapsed since the Act took effect.

¹ As to the constitutionality of this feature, see *infra* § 149. Compare also *supra* § 29.

² *Spreckels Sugar Ref. Co. v. McClain*, 109 Fed. 76, 79 (reversed on other points, 113 Fed. 244; 192 U. S. 397).

Cf. *Merchants' Ins. Co. v. McCartney*, 1 Lowell 447 (under Income Tax of 1862).

³ The Act provides that it "shall take effect on the day following its passage." Act, § 42 (*infra* Appx. I).

⁴ See *infra* § 84A.

§ 40. **Income Derived from Property Exempt from Federal Taxation.** — Income derived from property which Congress has no power to tax, either directly or indirectly, such as state and municipal bonds, should not, it is submitted, be included in the amount of the gross income for purposes of this tax. The statute does not so provide, but on the contrary apparently contemplates that such income shall be included in the assessment. It is, however, submitted that in so far as the Act attempts to include such income in the assessment, it is unconstitutional and void. By the unanimous judgment of the Supreme Court, Congress has no power to tax income derived from State and municipal securities.¹

It may be claimed, however, that this tax is not laid upon income but upon the business, and that although Congress cannot tax the income derived from state or municipal securities, yet it may tax a business as a whole although the business is supported in whole or in part by income derived from exempt securities. Thus, a bank may be taxed on the amount of its deposits although the money deposited is invested in exempt securities;² and so a tax may be laid on shares of stock in proportion to their value ascertained by dividing the total assets of the corporation by the number of its shares outstanding, although some of the

¹ *Pollock v. Farmers' L. & T. Co.*, 157 U. S. 429; 15 Sup. Ct. Rep. 673; 158 U. S. 601; 15 Sup. Ct. Rep. 912.

² *Society for Savings v. Coite*, 6 Wall. 594.

property of the company may be invested in securities which are constitutionally exempt from taxation.¹ So, a state tax may be laid on the privilege of taking property by will although the tax is proportioned to the value of the property so passing and although the property consist of United States bonds;² but this is because the privilege of willing property, even United States bonds, might be wholly taken away by the States. On the same principle, a state may levy a tax on the right to exist as a corporation and may proportion the tax to the amount of dividends declared by the company although some of the income used to pay the dividends comes from interest on United States bonds;³ but this is

¹ *Crown Cork & Seal Co. v. State*, 40 Atl. 1074; 87 Md. 687; 53 L. R. A. 417; *St. Louis Bldg. etc. Ass'n v. Lightner*, 47 Mo. 393; *Cleveland Trust Co. v. Lander*, 19 Oh. Circ. Ct. 217; *Charleston Nat. Bank v. Melton*, 171 Fed. 743.

² *Murdoch v. Ward*, 178 U. S. 139; 20 Sup. Ct. Rep. 775; *Plummer v. Coler*, 178 U. S. 115; 20 Sup. Ct. Rep. 829.

³ *Home Insurance Co. v. New York*, 134 U. S. 594; 10 Sup. Ct. Rep. 593. Cf. *Philadelphia Contributionship v. Commonwealth*, 98 Pa. 48 (upholding state statute levying a tax on certain corporations measured by their annual "net earnings or income from all sources" although some of the income was derived from United States bonds, but to be compared with *Philadelphia etc. S. S. Co. v. Pennsylvania*, 122 U. S. 326; 7 Sup. Ct. Rep. 1118, where the same statute was held unconstitutional as applied to corporations engaged in interstate commerce, and with *New York, Lake Erie etc. Co. v. Pennsylvania*, 158 U. S. 431; 15 Sup. Ct. Rep. 900, where one provision of the statute was held valid).

because the state might altogether withhold the right to exist as a corporation and may therefore exact such taxes or payments as it pleases in exchange for conceding that right.

Similar reasoning cannot be used to sustain the present tax, because the federal government has no power to take away from companies existing under state laws the privilege of acquiring income from state and municipal securities. Hence, even if we assume that the present tax is laid, technically, on the business, nevertheless it is certainly proportioned to the income derived from all sources, so that if income from exempt securities is included, the same practical result is reached, so far as this point is concerned, as if the tax were laid, nominally and technically as well as substantially, upon that income. State and municipal securities are exempt because of the rule of constitutional policy which prevents the federal government from taxing the instrumentalities of the states. It is a practical and not a mere technical rule. It forbids a tax laid indirectly, as well as directly, upon the exempted property. Surely, therefore, the income for purposes of this federal tax must be estimated without including income derived from state and municipal securities.

It would seem to follow that the earnings of a corporation on a contract with the state—for example, the profits of a construction company on a contract for the erection of a public build-

ing — should be exempt from this federal tax.¹

§ 41. **Income Derived from Land.** — It is also to be doubted whether, even if the whole Act is not unconstitutional as laying an unapportioned direct tax, income derived from real estate should be included in making up the assessment.² In the *Income Tax Cases*,³ although the court at the first hearing was equally divided upon the question whether a general tax on the income of all personal property was a direct tax, yet six out of the eight judges who were then sitting concurred in holding a tax on the income of land to be a direct tax. Of those six judges, one⁴ seems to have changed his opinion on this point on the rehearing, and the minority was reinforced by the ninth judge who had not been present at the first hearing. Upon the rehearing, therefore, the court decided by a vote of five judges to four that a tax on income derived from land is a direct tax. If, then, the present tax is to be regarded as a tax on income, the income from real estate must be deducted

¹ But see *Manhattan Co. v. Blake*, 148 U. S. 412; 13 Sup. Ct. Rep. 640 (holding that a federal tax may be levied against a bank proportioned to the average amount of its deposits, although some of the deposits represented money deposited by the state treasurer to be disbursed by the bank in payment of debts of the state).

² See *infra* § 141–§ 144.

³ *Pollock v. Farmers' L. & T. Co.*, 157 U. S. 429; 15 Sup. Ct. Rep. 673; 158 U. S. 601; 15 Sup. Ct. Rep. 912.

⁴ Mr. Justice Brown.

unless the Income Tax Cases are to be overruled.

§ 42. **Income from Invested Personal Property.**—At the rehearing of *Pollock v. Farmers' Loan and Trust Co.*,¹ the Supreme Court decided, by the same bare majority of five judges to four, that a tax on the income of invested personal property is a direct tax. If that decision stands, and if the present law is a tax on income, it follows that although it expressly includes income derived "from all sources," including investments, yet it is unconstitutional, because not apportioned among the states in the ratio of population, so far as income from investments is concerned. If that be so, unless the Act is to be held void *in toto*, the assessment of this tax should be made solely with reference to income from business and excluding all income derived from investments.

§ 43. **What is Income from Business as Distinguished from Income from Investments.**—Hence, it becomes necessary to inquire what should be included as income from the business as distinguished from income from invested capital.²

¹ 158 U. S. 601; 15 Sup. Ct. Rep. 912; 157 U. S. 429; 15 Sup. Ct. Rep. 673.

² Cf. *Clerical, etc. Ass. Soc. v. Carter*, 22 Q. B. D. 444 (where it was contended unsuccessfully that interest arising from investments by a life insurance company, whose business it is to deal in money, was to be taxed merely in ascertaining the profits of the business and not as "interest of money" invested); *Reid's Brewery Co. v. Male* (1891), 2

This precise question has been raised a few times in connection with the War Revenue Act of 1898 which expressly levied an excise tax on the net income derived from certain specified occupations, notably that of refining sugar.¹ The Supreme Court held that rentals of a wharf which was chiefly used by a sugar-refining company for the unloading of vessels transporting raw sugar to its refinery should be regarded, not as income from invested real estate, but as part of the income derived from the business.² On the other hand, it was held that interest paid to the company on money in bank was not part of the income of its business.³ So also, receipts from stevedoring done in unloading cargoes of sugar consigned to the company are not to be included when they are properly chargeable to the vessels.⁴ It was also held by a Circuit Court that dividends on stock

Q. B. 1 (where a distinction was taken by the Court between money lent in the business and money lent as an investment); *Central Trust Co. v. Treat*, 171 Fed. 301 (where invested accumulated profits were held not taxable as "capital and surplus" of a bank, because not used in the banking business).

¹ Act, June 13th, 1898, c. 448, § 28 (2 U. S. Comp. Stats. p. 2306).

² *Spreckels Sugar Ref. Co. v. McClain*, 192 U. S. 397; 24 Sup. Ct. Rep. 376; 113 Fed. 244; 51 C. C. A. 201.

³ *Spreckels Sugar Ref. Co. v. McClain*, 192 U. S. 397; 24 Sup. Ct. Rep. 376.

⁴ *Spreckels Sugar Ref. Co. v. McClain*, 109 Fed. 76, 79; (reversed on other points, 113 Fed. 244; 51 C. C. A. 201; 192 U. S. 397; 24 Sup. Ct. Rep. 376).

of another corporation of which the taxpaying company was the sole shareholder were taxable;¹ but this decision seems inconsistent with the opinion of the Supreme Court in the Spreckels Case and other authorities,² and moreover that precise question cannot well arise under the present Act, because dividends on stock in other companies subject to the Act are exempt.

A class of cases which may perhaps throw some light on this question, relate to exemptions from taxation. When, for instance, a railway company is exempted from taxation, it is held that only such property is exempted as it uses in connection with its business, and not property which it holds merely as an investment.³ Applying this distinction, it has been held that the exemption did not extend to the following property: property acquired under a statute amendatory of the charter;⁴ lands held for sale and not for use;⁵ portions of banking house let to tenants;⁶ real estate in excess

¹ *American Sugar Ref. Co. v. Rutan*, 123 Fed. 979.

² *Gramophone & Typewriter v. Stanley* (1908), 2 K. B. 89. See also 2 Machen, *Mod. Law of Corps.*, § 1080, and *supra* § 34.

³ See 1 Cooley on Taxation, 3d ed., 375 et seq.; 12 Am. & Eng. Enc. of Law, 2d ed., 359, 362-366, tit. "Exemptions from Taxation."

⁴ *Ford v. Delta & Pine Land Co.*, 164 U. S. 662; 17 Sup. Ct. Rep. 230; *Southwestern R. R. Co. v. Wright*, 116 U. S. 231; 6 Sup. Ct. Rep. 375; *State v. B. & O. R. R. Co.*, 48 Md. 49, 80.

⁵ *Tucker v. Ferguson*, 22 Wall. 527, 574.

⁶ *Bank v. Tennessee*, 104 U. S. 493.

of the quantity the company could acquire by condemnation;¹ lands vacant or let at a rental to tenants;² timber lands acquired by railway company in order to convert the timber into cross-ties and lumber for its own use;³ lands acquired by railway company for dwellings for employees, for car or locomotive factories, coal mines, etc.;⁴ steamboats acquired by a railway company;⁵ grain elevator leased to private persons by railway corporation;⁶ and hotels constructed on the land of a railway company as summer resorts.⁷

§ 44. **Income from Ultra Vires Business.** — A corporation would be taxable in respect of income

¹ *Vermont Central R. Co. v. Burlington*, 28 Vt. 193.

² *County of Ramsey v. Chicago etc. Ry. Co.*, 33 Minn. 537; 24 N. W. 313; *State v. Collectors*, 25 N. J. Law 315.

³ *County of Todd v. St. Paul etc. Ry. Co.*, 38 Minn. 163; 36 N. W. 109.

⁴ *State v. Commissioners of Mansfield*, 23 N. J. Law 510; 57 Am. Dec. 409n (but holding that stations, car and engine-houses, tanks and repair-shops are covered by the exemption).

Cf. *Railroad v. Berks County*, 6 Pa. St. 70 (taking a similar line of distinction); *Inhabitants of Worcester v. Western Railroad Co.*, 4 Met. 564 (strip five rods in width held exempt though not covered by tracks but used for stations, engine-houses, etc.).

⁵ *Illinois Central R. R. Co. v. Irwin*, 72 Ill. 452.

⁶ *Re Swigert*, 119 Ill. 83; 6 N. E. 469. Cf. *State v. B. & O. R. R. Co.*, 48 Md. 49, 76-77.

⁷ *State v. B. & O. R. R. Co.*, 48 Md. 49, 77-78 (*secus* as to hotels constructed mainly for the accommodation of passengers).

derived from an *ultra vires* business to the same extent as if it were *intra vires*.¹

§ 44A. Income from Foreign Business and Property. — It is quite clear that in the case of domestic companies the Act intends to include within the tax income from foreign property and business to the same extent as income from business carried on and property existing within the United States. This is the necessary force of the unqualified expressions used — particularly, of the expression “from all sources.”² To this effect, also, are the regulations of the Commissioner of Internal Revenue.³ It seems, therefore, that even income from foreign real estate is included — a curious result, in view of the principle of the Income Tax Cases that a tax on income is equivalent to a tax on the property from which it is derived.

§ 45. Deductions to be Made from Gross Income — Is Statutory List of Deductions Exhaustive? — After the gross income has been determined, the next step is to ascertain the deductions which are to be made therefrom in order to arrive at the net income. The Act expressly enacts that certain

¹ *Salt Lake City v. Hollister*, 118 U. S. 256; 6 Sup. Ct. Rep. 1055; *People ex rel. Devoe Co. v. Roberts*, 51 N. Y. App. Div. 77; 64 N. Y. Supp. 494. But see *People ex rel. Wall etc. Co. v. Miller*, 181 N. Y. 328, 334.

² Act, Par. 1, line 19; Par. 2, line 5; Par. 3, line 44 (*infra* Appx. I).

³ Int. Rev. Regs. No. 31, Dec. 3d, 1909, Art. I (*infra* Appx. II).

classes of deductions *shall* be made, some of which deductions would not be proper in estimating net income if they had not been expressly allowed by law.¹ It does not say in so many words that no other deductions are to be permitted.² Accordingly, it is submitted that if there are any additional kinds of deductions which ought to be made from gross income in order to ascertain the net income, then the statutory list of required deductions ought not to be taken as exhaustive, so as to forbid by implication any such additional deductions.

It is true that Paragraph 3 provides that "there shall be deducted from the amount of the net income of each of such corporations, etc., *ascertained as provided in the foregoing paragraphs* of this section the sum of five thousand dollars, and said tax shall be computed upon the remainder of said net income."³ If any other deductions are made in addition to those enumerated in Paragraph 2, it may be contended that the net income is not "ascertained as provided" in that paragraph, although Paragraph 3 provides in language just quoted that the tax shall be computed upon net income "ascertained as provided in the foregoing

¹ See, for example, *infra* § 53.

² It differs in this respect from the British Income-Tax Act which expressly provides that net income shall be estimated "without other deduction than is hereinafter allowed": *Russell v. Town and County Bank*, 13 A. C. 418.

³ Act, Par. 3, lines 1-8 (*infra* Appx. I).

paragraphs." This contention, however, begs the question; for if Paragraph 2 does not forbid any additional deductions that may be proper according to general principles of law, and that are impliedly allowed by the provision of Paragraph 1 that the tax shall be proportioned to "net income,"¹ then the net income is ascertained as provided in Paragraphs 1 and 2 although such deductions be made. Paragraph 3 does *not* declare that the tax shall be computed upon the net income ascertained by making from the gross income the deductions enumerated in Paragraph 2 *and no others*.

The general question what expenses should be charged to capital and what to income has received consideration in the law of corporations in connection with dividends² and with income bonds.³

§ 46. Deductions Expressly Required — Maintenance and Operation — The Provision in General. — We proceed, therefore, to the examination of the deductions which are expressly allowed. The first of these is,⁴

"All the ordinary and necessary expenses actually paid out of income in the maintenance and operation of its business and properties, including all charges such as rentals or franchise payments required to be made as a condition to the continued use or possession of property."

¹ Act, Par. 1, lines 17-18 (*infra* Appx. I).

² See 2 Machen, *Mod. Law of Corps.*, § 1330-§1337.

³ See 2 Machen, *Mod. Law of Corps.*, § 2107.

⁴ Act, Par. 2, lines 6-12 (*infra* Appx. I).

This class of deductions would have been proper even if there had been no express requirement to that effect. In order to ascertain net income, it is clearly necessary to deduct the expenses of maintenance and operation.¹ It is, however, necessary to examine this clause of the Act somewhat minutely in order to see exactly what is directed to be deducted.

§ 47. What is "Maintenance and Operation" — **In General.** — The statute gives no definition of "maintenance and operation." This must be determined by dictionaries and general principles of law.² Observe that the Act does not confine the deduction to the expense of maintaining and operating the business and property during the

¹ Cf. 2 Machen, Mod. Law of Corps., § 1331, § 1332.

² Compare the authorities as to what claims are entitled to priority as "operating expenses" in a receivership of a railway or other company. 2 Machen, Mod. Law of Corps., § 1941-§ 1943, § 2048. See also Llewellyn's Appeal, 103 Pa. 458. For a liberal construction of the word "maintenance," see *Smith v. Grayson County* (Texas), 44 S. W. 921, 923. Cf. *Hesketh v. Bray*, 21 Q. B. D. 444 (expense of constructing a sea-wall for reclamation of a salt-marsh held not proper to be deducted from income under a statute allowing deduction of the expense of constructing sea-walls "necessary for the preservation or protection of such lands against the encroachment or overflowing of the sea or any tidal river"); *Central R. R. Co. v. Collins*, 40 Ga. 582 (as to construction of a charter power of "maintaining and sustaining" a railway). As to deduction of sums necessary to be expended in collecting debts, etc., see *Stevens v. Bishop*, 20 Q. B. D. 442 (distinguished in *Duke of Norfolk v. Lamarque*, 24 Q. B. D. 485).

year, but that a payment made during the year for maintaining or operating the company during some previous year is also to be deducted.¹ Where a payment is made for a new improvement replacing an old structure, so much of the expenditure as would be necessary as repairs to keep the old structure up to its normal condition is properly chargeable to maintenance.² It may be questioned whether damages paid for torts committed in the course of the business are to be treated as expense of maintenance or are more properly classified as a "loss."³ A gross payment to an officer in commutation of his salary is a capital charge where the payment is made in pursuance of a stipulation in a contract whereby the company bought the business of a former concern and agreed as part of the consideration to pay a salary to this officer during life.⁴ It has been held in England that money paid to an association of employers which indemnified subscribers against strikes was not to be deducted from gross income under the British Income Tax Acts as "money wholly and exclusively laid out for the purposes of the trade;"⁵ but nevertheless it is submitted that a fair construction of the words "maintenance

¹ Cf. *infra* § 96.

² *Grant v. Hartford etc. R. R. Co.*, 93 U. S. 225, 228.

³ Cf. *Strong & Co. v. Woodfield* (1906), A. C. 448.

⁴ *Royal Ins. Co. v. Watson* (1897), A. C. 1, affirming *Watson v. Royal Ins. Co.* (1896), 1 Q. B. 41, on somewhat different grounds.

⁵ *Rhymney Iron Co. v. Fowler* (1896), 2 Q. B. 79.

and operation" in the present law would entitle the company to deduct any such payments in the nature of premiums for insurance. Other English cases take a similar narrow view of the expenses which may be allowed as trade expenses.¹

§ 48. **Maintenance of Property.** — The deduction required is of the expense of maintenance and operation of the "business and properties." In the parallel clause with respect to foreign companies, the language is "business and property" in the singular number.² It would seem that no significance attaches to this slight variation. The insertion of the word "property" or "properties" is significant, however; for while the Act professes to lay a tax on business so as to obviate constitutional objections, yet in almost every

¹ See *Southwell v. Savill Bros.* (1901), 2 K. B. 349 (money spent by brewery in procuring licenses for houses in which it might be interested held not a mere operating expense); *Brickwood & Co. v. Reynolds* (1898) 1 Q. B. 95 (repairs to premises rented by a brewery to retail dealers contracting to buy from no other brewers held not deductible from gross income of brewery).

But see *Russell v. Town and County Bank*, 13 A. C. 418 (tending towards a more liberal view, and allowing a banking company to deduct the full rental value of its business premises including the part thereof occupied by their manager as a dwelling house); *Smith v. Lion Brewery Co.* (1909), 2 K. B. 912 (cost of liquor licenses of retailers renting premises from brewery and covenanting to sell only that company's beer may, when deducted from the rent, be treated as a trade expense of the brewery).

² See *infra* § 80.

paragraph a distinction is drawn between the business and the property of the company. The income from both is to be included in the assessment; and the expenses of maintaining both are to be deducted.

§ 49. **Expenses "Actually Paid" — Meaning of the Expression.** — It is only expenses "actually paid" ¹ which are required to be deducted: a liability which has been incurred but not discharged is not to be included. This is no serious hardship because the deduction could in that case be made the next, or any subsequent, year; for as already stated the deduction is not confined to the expense incurred for maintenance and operation during the year for which the tax is levied.² The force of the words "actually paid" should not be pressed too far.³ It is not as if the Act had said "actually paid in cash," although even in that case a set-off by mutual agreement of an existing debt owing to the company would be

¹ Act, Par. 2, line 7 (infra Appx. I).

² Supra § 47.

³ The Regulations of the Treasury Department give them a very liberal interpretation in favor of the corporations, and indeed practically deprive them of all meaning. U. S. Int. Rev. Regs. No. 31, Dec. 3d, 1909, Art. 4 (infra Appx. II). Cf. U. S. v. Louisville & N. R. Co., 33 Fed. 829 (holding that a consolidation of two railway companies amounts to a payment of interest due by one to the other within the meaning of an Act of Congress taxing interest paid, but is presumably not paid from the "earnings" of the debtor within the meaning of that statute).

equivalent to payment.¹ As it is, it would seem that according to the fair meaning of the words used, they are equivalent to actually discharged or satisfied. However, it has been held in England that where an insurance company advances a part of the premiums to the insurer as a loan on the security of the policy, giving him a receipt for the full premium, the amount so advanced cannot be treated by the insurer as "paid by him" within the meaning of the British income-tax laws, and therefore deductible from his gross income.²

§ 50. **Necessity that Expenses Should Have Been Paid "out of Income" in Order to be Deducted.** — In order to come within the clause now under consideration the expenses must not merely be paid but must be paid "*out of income.*"³ In the corresponding clause as to foreign companies, the words are "out of *earnings*";⁴ and in the Third Paragraph of the Act domestic as well as foreign companies are required to make a return to the collector of the amounts expended for maintenance and operation "*out of earnings,*" instead of income.⁵ It would seem, therefore, that

¹ Cf. 1 Machen, Mod. Law of Corps., § 794, § 797, as to the construction which has been given to statutes requiring "payment in cash" for shares.

² Hunter v. Rex (1904), A. C. 161.

³ Act, Par. 2, line 7 (infra Appx. I).

⁴ Act, Par. 2, lines 51-52 (infra Appx. I).

⁵ Act, Par. 3, line 58 (infra Appx. I).

Congress used the words "earnings" and "income" in this connection as synonymous and interchangeable. Nevertheless, they are not properly identical in meaning; for "income" includes receipts from invested capital whereas "earnings" should be confined to profits from the transaction of business. However, Congress must have intended in this place to use earnings in the broader sense more properly attached to the other word.

By the general principles of law, if a revenue charge is paid out of capital, it may properly, and perhaps must, be carried over to the revenue account and deducted from the balance of profit shown thereby before any part thereof can be treated as profit applicable to dividends.¹ Do the words "out of income" prohibit a similar action in calculating net income for the purpose of the tax? So to hold would be a narrow, technical and unjust construction; for it is difficult to see what reason could actuate the legislature in prohibiting recoupment out of gross income for maintenance expenses which have been borne in the first instance by capital. And yet unless that construction is given to the words "out of income," they seem to have no meaning whatsoever.

Even if the words referred to should be held to prohibit the inclusion under this head of maintenance charges borne by capital, the amount of capital so consumed might be treated as a "loss"

¹ 2 Machen, Mod. Law of Corps., § 1331, § 1328.

and included under the second class of deductions prescribed in the Act.¹

§ 51. **Meaning of "Ordinary and Necessary" Expenses.**—The language of the Act is that "the *ordinary and necessary* expenses" of maintenance and operation shall be deducted. Must an expense be both ordinary and necessary in order to fall within this clause? It would seem not. The intent was to include both all the ordinary expenses, and also all extraordinary but necessary expenses. The meaning would perhaps have been a little clearer if the word "the" had been repeated before the word "necessary." It would seem that under the head of extraordinary necessary expenses might come expenditures made during the year 1909 or some succeeding year for the purpose of making good a depreciation of fixed capital which occurred prior to 1909 and which therefore could not be credited as a deduction under Class 2 of the prescribed deductions.²

§ 52. **Charges such as Rentals or Franchise Payments.**—The Act expressly provides that "all charges such as rentals or franchise payments required to be made as a condition to the continued use or possession of property" shall be included as operating expenses. This would seem to be mere surplusage;³ for such expenditures would

¹ As to which see *infra* § 53–§ 59.

² U. S. Int. Rev. Regs., No. 31, Dec. 3d, 1909, Art. 4 (*Infra* Appx. II).

³ As to the case where in addition to an annual rental

seem to be a typical example of expenses for operation and maintenance.¹

§ 53. Deductions for Losses — Necessity for an Express Provision of Law Allowing such Deductions. — The second class of deductions required to be made² embrace:

“All losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property, if any, and in the case of insurance the sums other than dividends, paid within the year on policy and annuity contracts and the net addition, if any, required by law to be made within the year to reserve funds.”

This is a very important class of the prescribed deductions; for it is possible that if deductions of this class had not been specifically directed some of them at least would have been held not proper to be allowed in calculating net income.³ For a large premium or bonus is paid for a lease, see *Gillatt v. Colquhoun*, 33 W. R. 258.

¹ As to a suggested case which might fall under this head, see *infra* § 70.

² Act, Par. 2, lines 12–21 (*infra* Appx. I).

³ *Philadelphia Contributionship v. Commonwealth*, 98 Pa. 48 (loss of capital by payment of bonds purchased at a premium not proper to be deducted in estimating taxable annual income).

But see *Little Miami etc. R. R. Co. v. United States*, 108 U. S. 277, 280; 2 Sup. Ct. Rep. 627 (holding that without express authorisation losses by depreciation of investments should be deducted in calculating taxable income); *United States v. Central Nat. Bank*, 10 Fed. 612 (holding that losses by embezzlement during the period covered by the tax

example, depreciation of fixed property may be disregarded in calculating profits for the purpose of dividends;¹ and it is quite possible that the courts might have held that it should be disregarded in calculating net profits for the purpose of this tax, if the law had not expressly declared the contrary.² Of course, even without any express statutory authority it would have been necessary in order to ascertain the net income to deduct all losses of circulating capital incurred within the year.³

§ 54. **Meaning of "Losses."** — The Act gives no general definition of "losses," but leaves the meaning to be ascertained by general principles of law. The thing itself is common enough, and perhaps the meaning of the word is correspondingly well understood. Loss by embezzlement would be included.⁴ So, loss by insolvency of debtors.⁵

§ 55. **Loss must be "Actually Sustained within the Year."** — In order to be within this provision the loss must be "actually sustained within the

should be deducted, but to be compared with S. C. on error to review judgment on an amended complaint, 137 U.S. 255).

¹ 2 Machen, Mod. Law of Corps., § 1325-§ 1328.

² *Alianza Co. v. Bell* (1906), A. C. 18; *Coltness Iron Co. v. Black*, 6 A. C. 315; *Forder v. Handyside*, 1 Ex. D. 233.

But see *Little Miami etc. R. R. Co. v. United States*, 108 U. S. 277; 2 Sup. Ct. Rep. 627 (stated supra). See also *infra* § 57.

³ *Lawless v. Sullivan*, 6 A. C. 373.

⁴ *United States v. Central Nat. Bank*, 10 Fed. 612 (to be compared with S. C. at a subsequent stage, 137 U. S. 255).

⁵ *United States v. Mayer, Deady* 127.

year”¹ — that is within the calendar year² for which the tax is assessed. It may not always be easy to determine the precise moment of time when a loss is “sustained”; but in general little difficulty will be encountered.

§ 56. **Must be “Not Compensated by Insurance or Otherwise.”** — To be within the statute, the loss must be “*not compensated by insurance or otherwise.*”³ Suppose a loss is covered by insurance in a company which denies its liability, or suppose the insurance has not been collected: is the loss in such cases “compensated by insurance” within the meaning of the Act? Perhaps in such cases, the loss should be taken to be “compensated by insurance”; and if it should subsequently prove impossible to collect the loss, either by a judgment in favor of the insurance company in a suit on the policy, or because of the supervening insolvency of the insurance company, then the amount of the original loss covered by the policy might be treated as a loss occurring in the year in which the impossibility of collecting the insurance became established.

The meaning of the words “or otherwise” is very obscure. They certainly must be confined to cases in which the loss is compensated either by insurance or something *ejusdem generis* — e. g. by a guarantor. Certainly those words could have

¹ Act, Par. 2, line 13 (*infra* Appx. I).

² See *infra* § 84A.

³ Act, Par. 2, lines 13–14 (*infra* Appx. I).

no application where the loss is made good by voluntary contributions by the shareholders, or by assessments upon them; or where the loss is counterbalanced by profits.

§ 57. **Depreciation of Property.**—The importance of the provision as to depreciation of property¹ has been already adverted to.² It evidently covers depreciation of all kinds—by wear and tear, by the diminution in value of wasting assets, such as mines, leases or patents, or in consequence of supersession by improved apparatus, and in fact diminution in value of all kinds. But for this express provision, it might have been plausibly argued, and perhaps would have been held, that a depreciation in the value of a company's fixed capital does not in any way diminish the net income.³ It is only depreciation occurring *within the year* that is required to be deducted; this is the only reasonable meaning of the statute, and is expressly declared by the Commissioner of Internal Revenue in his published regulations.⁴ However, all depreciation within the year must be allowed notwithstanding the fact that in previous years allowances for depreciation

¹ Act, Par. 2, lines 14–16 (*infra* Appx. I).

² *Supra* § 53.

³ This is true under the English Income Tax Laws: *Gillatt v. Colquhoun*, 33 W. R. 258; *Coltness Iron Co. v. Black*, 6 A. C. 315; *Alianza Co. v. Bell* (1906), A. C. 18; *Forder v. Handyside*, 1 Ex. D. 233. *Supra* § 53.

⁴ U. S. Int. Rev. Regs., No. 31, Dec. 3d, 1909, Art. 4 (*infra* Appx. II).

or wear and tear aggregating the full value of the property may have been made to the company.¹

§ 58. **Deductions by Insurance Companies —** “Sums other than Dividends Paid within the Year on Policy and Annuity Contracts.” — The Act prescribes two peculiar deductions in the case of insurance companies.² The first of these is “the sums other than dividends paid within the year on policy and annuity contracts.”³ This may mean that insurance companies shall be allowed to deduct all losses paid by them within the year. As such losses constitute debts of the companies, they would fall under the general head of deductions for indebtedness, which will be considered under the next heading. It may, however, be said here that the net income of an insurance company certainly could not be ascertained without deducting losses paid by the corporation; and accordingly the same deductions would have been necessary if the Act had merely laid a tax in proportion to the company's net income without fixing any regulations for its ascertainment.⁴

Any other rule would be grossly unjust. As this express provision applies only to insurance companies, and as many similar cases in respect

¹ *John Hall, Junior, & Co. v. Rickman* (1906), 1 K. B. 311.

² Act, Par. 2, lines 16–21 (*infra* Appx. I). As to what is an insurance company within the meaning of the Act, see *supra* § 20.

³ Act, Par. 2, lines 17–19 (*infra* Appx. I).

⁴ Cf. *Gresham Life Ass. Soc. v. Styles* (1892), A. C. 309.

to other companies may arise, one can readily understand the injustice which might result from holding the statutory list of deductions to be exclusive. Perhaps, however, even if the statutory list should be held to be exclusive, payments similar to payments of losses by insurance companies might be regarded as operating expenses, and deductible as such.

In England, it is held that an insurance company in calculating its taxable income cannot make any allowance for unearned premiums paid for risks outstanding at the close of the year, but that the income should be ascertained by deducting the total expenditures during the year from the total receipts during that period, leaving outstanding risks to be deducted, in case of loss, as an expense during the next year.¹

§ 59. **Insurance Companies (Continued) — Additions to Reserve Funds.** — The second kind of peculiar deductions prescribed in the case of insurance companies is "the net addition, if any, required by law to be made within the year to reserve funds."² This would hardly be proper as an item to be deducted in ascertaining net income if the statute had not expressly so provided; for an addition to a reserve fund is simply an

¹ *Imperial Fire Ins. Co. v. Wilson*, 35 L. T. N. S. 271; *General Accident etc. Corp. v. McGowan* (1908), A. C. 207 (where, however, the Lord Chancellor admitted that method approved by the court was "not scientifically unassailable").

² Act, Par. 2, lines 19-21 (*infra* Appx. I).

accretion to the company's capital moneys. Consequently, in order that such a deduction should be allowed it must be brought strictly within the statute. And in order to be within the Act, the addition to the reserve must be, in the first place, "*required.*" A voluntary addition is not to be deducted, except, indeed, that the last clause of the Second Paragraph of the Act provides that "in assessment insurance companies the actual deposit of sums with State or Territorial officers, *pursuant* to law, as additions to guaranty or reserve funds shall be *treated* as being payments *required* by law to reserve funds." Secondly, it must be "*required by law.*" If the company is incorporated by special act, it would be sufficient if the addition to the reserve were required by that act, which of course is a law. But a requirement in the company's by-laws, or in the incorporation paper of a company incorporated under general laws, would not come within the Act of Congress. Thirdly, the addition to the reserve must be "*required by law to be made within the year.*"¹ It is not enough that it is actually made within the year; and conversely, perhaps, the deduction may be allowed even though the addition to the reserve is not made within the year if it is required so to be.

§ 60. **Indebtedness — The Provision in General.**
— The next deduction relates to indebtedness.²

¹ Act, Par. 2, lines 20-21 (*infra* Appx. I).

² Act, Par. 2, lines 21-30 (*infra* Appx. I).

The provision is that there shall be deducted:

“Interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the paid-up capital stock of such corporation, joint stock company or association, or insurance company, outstanding at the close of the year, and in the case of a bank, banking association or trust company, all interest actually paid by it within the year on deposits.”

It may be urged that in accordance with the *ejusdem generis* rule of construction the words “or other” in the phrase “bonded or other indebtedness” should be construed as referring only to indebtedness of the same general character as bonded indebtedness¹ — in other words funded as distinguished from floating indebtedness. Probably this construction should be adopted; for floating indebtedness should ordinarily be paid outright, principal and interest, out of income,² so that payments made for that purpose may be regarded as necessary operating expenses and as such deductible from the gross income under the first class of deductions specified in this law. Moreover, the phrase we are now considering apparently contemplates not an indebtedness of fluctuating amount, but an indebtedness whose amount can be ascertained with accuracy and can

¹ As to the meaning of “bonded indebtedness,” see 2 Machen, Mod. Law of Corps., § 1679.

² 2 Machen, Mod. Law of Corps., § 1333, § 2107.

be compared in respect to stability with the amount of the capital stock.

It is only interest "*actually paid* within the year" ¹ that is directed to be deducted. The meaning of those words has been already discussed in another connection.²

§ 61. Limitation on Amount of Indebtedness — What is the Paid-up Capital Stock. — The statute directs that there shall be deducted all interest actually paid within the year on an amount of indebtedness "*not exceeding the paid-up capital stock . . . outstanding at the close of the year.*" ³ Now, the words "capital stock" are usually ambiguous, and may refer either to the company's nominal capital or to its actual capital or assets,⁴ and in a tax law they are usually construed to apply to the company's actual assets rather than its nominal capital.⁵ Nevertheless, in this case, it would seem to refer to the nominal capital; for although "capital stock" alone may refer either to the nominal capital or to the actual capital or assets, yet "paid-up capital stock" cannot well refer to anything but the nominal capital stock. To speak of the "paid-up assets" of the company

¹ Act, Par. 2, lines 21-22 (*infra* Appx. I).

² *Supra* § 49.

³ Act, Par. 2, lines 24-28 (*infra* Appx. I).

⁴ 1 Machen, *Mod. Law of Corps.* § 497.

⁵ *State v. Taylor* (Ill.), 89 N. E. 271; *People ex rel. Union Trust Co. v. Coleman*, 126 N. Y. 433; 27 N. E. 818; 12 L. R. A. 762 (with annotation and citation of additional authorities).

would be absurd. In case the stock is illegally watered, perhaps only so much of the nominal capital should be taken into account for this purpose as is legally paid up.¹ If, however, the stock is lawfully credited as paid up though without actual payment — for example, in case of a mistaken but *bona fide* overvaluation of property accepted as payment — under such circumstances, the full amount of the capital credited as paid up, and not merely the amount represented by the actual value of the property accepted in payment, should be regarded as “paid-up capital stock” within the meaning of this Act of Congress. Thus an additional inducement is added to the practice of stock-watering — rather a curious result of a statute most of whose advocates profess to regard that practice with abhorrence.

§ 62. As of what Date Amount of Capital Stock and of Indebtedness is to be Taken. — The amount of the paid-up capital stock is to be estimated at the close of the year; for the language is, “not exceeding the paid-up capital stock . . . outstanding at the close of the year.”² It would seem that the amount of indebtedness is to be estimated at the same time; for Paragraph Three requires the

¹ But compare the prevalent American doctrine that shares issued at a discount in violation of law are nevertheless to be taken as paid-up as against all the world except subsequent creditors of the company: 1 Machen, Mod. Law of Corps., § 776.

² Act, Par. 2, lines 27–28 (*infra* Appx. I).

company to make a return of "the amount of the bonded and other indebtedness . . . at the close of the year." If, however, the indebtedness during the earlier part of the year exceeded the capital stock, is the interest paid on the whole amount to be deducted merely because the indebtedness has been reduced below the capital stock before the end of the year? In truth, the limit upon the amount of interest deductible is without any justification in reason; for surely the larger the indebtedness on which a company is obliged to pay interest, the smaller is its income. The provision seems intended as a penalty on a corporation for contracting an indebtedness in excess of its capital stock, and in that aspect is an encroachment on the reserved rights of the states.

§ 63. Force of Word "Outstanding" in "Capital Stock Outstanding at Close of the Year." — The reference is to the amount of the paid-up capital stock "outstanding" ¹ at the close of the year. "Outstanding," of course, means issued,² and not validly surrendered. Stock which has been acquired by the company itself in any lawful way — by forfeiture, by surrender as "treasury stock," or (where a purchase by a company of its own stock is deemed lawful) by purchase, — is of course not to be taken as outstanding;³ but on

¹ Act, Par. 2, line 27 (infra Appx. I).

² As to when stock can be deemed "issued," see 1 Machen, Mod. Law of Corps., § 170-§174. In addition to cases there cited, see *Scott v. Abbot*, 160 Fed. 573, 577.

³ 1 Machen, Mod. Law of Corps., § 633.

the other hand shares purchased by the company *ultra vires* are to be deemed still outstanding.¹

§ 64. **Indebtedness of Non-Stock Corporations.** — In the case of companies which have no capital stock there is no limit to the amount of indebtedness interest upon which may be deducted from the gross income. But as the only non-stock corporations which are subject to the Act are, probably, insurance companies, and as insurance companies do not usually have a large funded debt, this absence of any limitation will not often be very important.

§ 65. **Interest on Indebtedness in Excess of the Paid-up Capital.** — If the indebtedness exceeds the paid-up capital stock, can interest paid on the excess be deducted from the gross income in ascertaining the net income on which tax is to be paid? ² The doctrine has been advocated above that the statutory list of deductions is not necessarily exhaustive; ³ but even if that doctrine is accepted as sound, it is hardly applicable here, because of the negative expression "not exceeding." ⁴ If the statute had provided that interest on indebtedness up to a given amount should be deducted,

¹ 1 Machen, Mod. Law of Corps., § 631. But see *United States v. Morse*, 161 Fed. 429.

² As to the general question whether interest on funded debt should be deducted in estimating net income for purposes of taxation, compare *Sioux City & Pac. R. R. Co. v. United States*, 110 U. S. 205; 3 Sup. Ct. Rep. 565.

³ *Supra* § 45.

⁴ Act, Par. 2, line 24 (*infra* Appx. I).

the argument might have been made that while a deduction of interest paid on that amount of indebtedness was *commanded*, interest paid on a larger amount was *not forbidden*. But when the statute says that interest paid on debts "not exceeding" a certain amount, shall be deducted, there seems to be a direct prohibition of a deduction of interest paid on a greater debt.

§ 66. **Money Used in Paying Principal of Debts — Moneys Added to Sinking Funds.** — The Act makes no express provision for deduction from gross income of amounts devoted to payment of debts. Nevertheless, as already indicated, it is submitted that sums used in paying floating indebtedness should be deducted, either as part of the operating expenses or because the statutory list of deductions is not intended to be exhaustive.¹ Money used in paying the funded debt should be charged to capital,² and therefore should not be deducted from the gross income in order to arrive at the net income. The Act of Congress, accordingly, quite properly contains no provision that money used for payment of the company's bonded indebtedness shall be deducted from the gross income. But although the payment of the funded debt ought not to be paid outright as an income charge, yet it is quite proper to lay by a reasonable sum from the gross income to go towards a sinking fund to pay the debt at maturity. May sums so

¹ Supra § 60.

² 2 Machen, Mod. Law of Corps., § 1333, § 2107.

laid by be deducted from the gross income for the purposes of this tax? The Act does not expressly so provide. If the deduction is permissible it must be either because the statutory list of deductions is not exclusive, or because reasonable contributions to a sinking fund for paying the funded debt at maturity may be held to fall within the class of operating expenses.

§ 67. **Interest on Bank Deposits.** — In the case of a banking or trust company,¹ the Act makes express provision that "all interest actually paid by it within the year on deposits," even though their amount may exceed the paid-up capital stock, shall be deducted from the gross income. The expression "actually paid" should be particularly noted.² The meaning of the same words in other parts of the Act has already been considered.³ They would seem to indicate that interest credited to the depositor but not actually paid to him cannot be deducted, — a queer result. However, the provision is that interest "paid within the year," and not interest accruing within the year, shall be deducted. Hence, if it should be

¹ As to what is a banking company, see *Bank for Savings v. Collector*, 3 Wall. 295 (savings bank held to be "engaged in the business of banking" within the meaning of a tax law); *Selden v. Equitable Trust Co.*, 94 U. S. 419 (a company engaged in business of investing its capital in bonds and selling same with its guaranty held not to be a bank).

² The word "actually" is omitted in the corresponding clause of the Third Paragraph. See *infra* § 98.

³ *Supra* § 49.

held that interest accruing on deposits should not be deducted from the income of the year within which it accrued, because although credited to the despositor it was not actually paid to him in that year, still it can be deducted from the income of any subsequent year in which it may be actually paid.

§ 68. **Deduction for Taxes — In General.** — The next deduction expressly directed ¹ is:

“All sums paid by it,” — i. e., the company, — “within the year for taxes imposed under the authority of the United States, or any State or Territory thereof, or imposed by the government of any foreign country as a condition to carry on business therein.”

Taxes imposed under the authority of any state clearly include municipal taxes as well as state taxes properly so called. The tax, in order to be deducted under this clause, must be paid within the year. It is not, however, necessary that it should have been assessed for that year, but it may be deducted although it had been allowed to fall into arrears before the beginning of the year.

The Act does not expressly require that the taxes shall have been assessed against the company, or that either the company or its property should be liable therefor. But presumably, a purely voluntary payment of taxes, for which neither the company nor its property is in any way liable, would not be within the purview of the clause. On the

¹ Act, Par. 2, lines 31-36.

other hand, taxes which are assessed upon the several shares to the holders thereof, but which the law may require the corporation to pay, would seem to be included.¹ The fact that the company may have a right of reimbursement against its several shareholders, does not, under this statute, affect the right to deduct the tax from the gross income. If the Act assesses income received by the company as trustee, — and as shown above, at least on the face of its language, it is a debatable question whether it does so,² — then certainly taxes assessed against the company as trustee, and paid by it in that capacity, should be deducted; otherwise it is more than doubtful whether any deduction for such taxes should be allowed.

§ 69. Special Assessments for Betterments. — Although the clause evidently applies to all forms of taxes, — on real estate and on personal property, direct and indirect, customs, duties, excises, licenses, and all other kinds of taxes, — nevertheless it is very questionable whether special assessments, or local betterment assessments, are included. The law is settled that an exemption from taxation does not carry an exemption from such local assessments;³ but in view of the strict-

¹ Of course, without express statutory authority, a corporation would not be entitled to deduct such taxes, in calculating its income for purposes of a law taxing its "earnings, income or gains": *Central Nat. Bank v. United States*, 137 U. S. 355; 11 Sup. Ct. Rep. 126.

² *Supra* § 38.

³ *Ford v. Delta etc. Co.*, 164 U. S. 662; 17 Sup. Ct. Rep.

ness with which exemptions from taxation are included, those decisions are not in point. Other authorities, however, which cannot be thus distinguished, hold that the word "tax" *prima facie* excludes special assessments.¹ The Income Tax Law of 1894 expressly declared that special assessments should not be deducted in estimating net income for purposes of the tax.² On the other hand, such assessments are levied in exercise of the power of taxation,³ and are therefore "taxes" in the broadest sense of that word.⁴ The conclusive argument against allowing deductions to be made on account of such assessments is that they are levied in supposed partial compensation for an enhancement in the value of property caused by a local improvement, and are therefore in the nature of an expense for permanent improvements, which are properly chargeable to capital rather than income.

§ 70. **Foreign Taxes.** — The only foreign taxes which are required to be deducted are those which are "imposed by the government of any foreign country as a condition to carrying on business therein." Other taxes, such as ordinary taxes on

230; *Illinois Central R. R. Co. v. Decatur*, 147 U. S. 190; 13 Sup. Ct. Rep. 293.

¹ *Lamar Water etc. Co. v. Lamar*, 32 L. R. A. 157, 165; 128 Mo. 188; 26 S. W. 1025; 31 S. W. 756; *Page & Jones on Taxation by Assessment*, § 39.

² Act, Aug. 27, 1894, c. 349, § 28.

³ *Page & Jones on Taxation by Assessment*, § 8.

⁴ *Id.*, § 40, § 41.

foreign real estate owned by the company are not required to be deducted under this head. It is possible, however, that foreign taxes of this latter kind might be allowed to be deducted under the first head as operating expenses, or more particularly, as "charges such as rentals or franchise payments required to be made as a condition to the continued use or possession of property."¹

§ 71. **Dividends on Shares in Other Companies — In General.** — The last class of the statutory deductions to be made by the company comprises:²

"All amounts received by it within the year as dividends upon the stock of other corporations, joint stock companies or associations, or insurance companies, subject to the tax hereby imposed."

The evident general intent of this clause is to prevent double taxation, — a laudable purpose. The deduction which it directs would not have been permissible if the Act had merely proportioned the tax to the net income, without directing how that net income should be ascertained. Nevertheless the clause is not very happily drawn, and will probably accomplish some rather surprising results. Most of these could be avoided if the words "subject to the tax hereby imposed" could be read with "dividends" instead of with "corporations, joint stock companies or associations, or insurance companies." The clause would then read, "All

¹ Supra § 52.

² Act, Par. 2, lines 36-40 (infra Appx. I).

amounts received by it from dividends subject to the tax hereby imposed." This, however, not merely involves an awkward twisting of the words, but is also quite inadmissible because, as we have seen, this tax is not laid upon dividends at all.¹ In order to have accomplished its purpose, the clause ought to have read, "All amounts received from dividends paid out of income subject to the tax hereby imposed." As it is, very unequal results may be accomplished.

§ 72. Dividends on Shares in Companies Whose Net Income is less than Five Thousand Dollars. — The first question is whether a corporation whose net annual income is less than five thousand dollars is "subject to the tax,"² so that dividends paid by such a company to another corporation should be deducted from the latter's net income. It seems that this question should be answered in the affirmative.³ If so, a double exemption of five thousand dollars is allowed, and a door is opened for an evasion of the tax. For instance, a corporation whose annual income is twenty-five thousand dollars, desiring to avoid the tax, may organize five subsidiary corporations, and divide its business among them, taking their stock in exchange. Each company would then have an income of but five thousand dollars, and no tax at all would be payable. Of course, the exemption of five thousand

¹ *Supra*, § 13.

² Act, Par. 2, line 40 (*infra* Appx. I).

³ *Infra* § 87.

dollars is so small that this process of subdivision is not likely to be resorted to by any considerable number of corporations. The increase of expenses caused by subdivision into such small corporations, to say nothing of the resulting inconvenience, would be greater than the tax.

§ 73. **Dividends on Shares in Foreign Companies.** — A similar question is whether dividends paid to a domestic company on shares in a foreign company are to be deducted from the income of the domestic company for purposes of the tax, merely because the foreign company may transact a small portion of its business in this country, and may thus become "subject to the tax." It would seem that this question should be answered in the affirmative: for the language of the statute is quite clear, that all dividends on stock of companies which are "subject to the tax" are exempt; and surely a foreign company which is compelled to pay, and actually does pay a tax under this law is "subject to the tax."

§ 74. **Meaning of "Dividends" in this Connection.** — The last question in connection with this clause of the Statute is as to the meaning of the word "dividends."¹ Although it may be

¹ Act, Par. 2, line 37 (*infra* Appx. I). As to the meaning of the word in a tax law, see *Bailey v. Railroad Co.*, 22 Wall. 604; *Cary v. Savings Union*, 22 Wall. 38; *Bailey v. Railroad Co.*, 106 U. S. 109; 1 Sup. Ct. Rep. 62. As to whether the word includes stock dividends, see 1 Machen, *Mod. Law of Corps.*, p. 495, note 5; and also *Chicago etc. R. R. Co. v. Page*, 1 Biss. 461 (statute taxing "dividends in scrip or

true that only such dividends as constitute income, as distinguished from an accretion to the shareholder's capital, are intended to be deducted under this head, yet the vexed questions that arise between a tenant for life and a remainderman, when an extraordinary dividend is claimed by the one as income and by the other as capital,¹ cannot become very material here;² for if we assume that an extraordinary dividend is capital and therefore ought not to be deducted from the gross income as "dividends" on the stock of another company subject to the tax, then it must follow that the amount thereof ought not to be included in the estimate of gross income. It is therefore as broad as it is long; anything that ought to be included in the gross income ought, if it was received in respect of ownership of shares in a company subject to the tax, to be deducted as a dividend. Thus it would seem clear that dividends in liquidation are not deductible as dividends; for they are paid out of capital, and not income; but if that be true, neither ought they to be included in the estimate of gross income. It may be urged that the word "amounts" in the expression "all amounts

money" held not to apply to stock issued to shareholders to represent their interest in property acquired by the company with accumulated profits prior to the passage of the statute). The expression "amounts received" as dividends in this statute might seem to indicate that Congress had only cash dividends, and not stock dividends, in mind.

¹ See 2 Machen, Mod. Law of Corps., § 1377-§1395.

² See also *supra* § 34.

received by it within the year as dividends " ¹ should be taken to imply that only cash dividends, as distinguished from stock or scrip dividends, or dividends payable in property, are intended; but that construction would be very narrow.

§ 75. **Method of Calculating Taxable Income of Foreign Companies — In General.** — We next consider the method of ascertaining the amount of income upon which foreign companies are taxed. As already stated, no foreign company is subject to the tax, unless it is "engaged in business" in the United States; ² and the meaning of the words "engaged in business" in this connection have already been discussed. ³ If, however, a foreign company is engaged in business in this country, it is taxable not merely upon the net income of that business, but also upon the income derived from "capital invested" within the United States, including Alaska. The method prescribed in the Act for ascertaining the net income upon which foreign corporations are taxable does not differ from that which is prescribed with respect to domestic companies, except in so far as may be rendered necessary by the fact that foreign companies are not taxable upon their total net income, but only upon so much thereof as is derived from business transacted and capital invested in this country.

¹ Act, Par. 2, lines 36-37 (*infra* Appx. I).

² *Supra* § 28.

³ *Supra* § 28.

§ 76. **Gross Income "From Business Transacted and Capital Invested in the United States."** — The first step prescribed in the statute towards ascertaining the taxable net income of foreign companies is to find the gross income from business transacted and capital invested within the United States, received within the year.¹ We have already considered the question, what is "gross income,"² and what is meant by the word "received."³ As these questions are precisely the same in the case of foreign companies as in the case of domestic companies, a repetition of that discussion would be superfluous. Moreover, the question, what is "business transacted within the United States" is necessarily answered by the discussion which has been already had as to the meaning of the words "engaged in business" in the United States.⁴ As, therefore, we are enabled from what has gone before to understand what is meant by "gross income received within the year," and by "business" which is transacted, or in which the company may be engaged, within the United States, little further discussion is necessary in order to determine the meaning of "gross income received from business transacted within the United States."

§ 77. **How to Apportion Profits Between that Part of Business Transacted in the United States,**

¹ Act, Par. 2, lines 41-50 (infra Appx. I).

² Supra § 33- §36, § 38-§ 44.

³ Supra § 37.

⁴ Supra § 28.

and that Part Transacted Abroad. — The question, however, of the apportionment of the company's profits between that part of its business which is carried on in the United States, and that part which is carried on abroad, is not always easy of solution.¹ The same or a similar question has repeatedly arisen under the British and Colonial income-tax laws. Where a telegraph company operated a cable from Australia to India, it was held that so much of its receipts as represented its portion of the price charged for telegraphic messages from New Zealand to Europe, were not derived from business done in New Zealand, although the company maintained an office in that colony;² but on the other hand, where a telegraph company maintained and operated a cable from England to the continent, it was held that all profits made by the company on messages from England to foreign countries were to be taken as derived from trade exercised within the United Kingdom.³ Where a company operated a mine in New South Wales, and refined its ores there, it was held that some part at least of the profit made on sales of the completed product in other colonies or countries arose from business carried

¹ As to the general question, what amounts to income from business as distinguished from income from other sources, see *supra* § 43.

² *Commissioner for Taxes v. Eastern Extension etc. Tel. Co.* (1906), A. C. 526.

³ *Ericksen v. Last*, 8. Q. B. D. 414.

on in New South Wales, and as such was assessable there for income tax;¹ but whether some part of the profit should be exempt as not having been earned in New South Wales, does not appear to have been decided. Profits in the shape of commissions on sales made in London upon consignments solicited and made in New Zealand do not arise out of business transacted in that colony.² When an English member of an American firm purchased goods in England and shipped them to New York, where they were sold at a profit, it was held that no part of that profit should be deemed to arise from the business carried on in England, and that therefore no part thereof was liable to income tax in England.³

§ 78. **What is Income from Capital Invested in United States.** — The expression “capital invested within the United States”⁴ introduces a new term.⁵ When may capital be said to be invested

¹ *Commissioners of Taxation v. Kirk* (1900), A. C. 588.

² *Lovell & Christmas v. Commissioner of Taxes* (1908), A. C. 46 (more fully stated *supra*, § 28, and note).

³ *Sully v. Attorney General*, 5 H. & N. 711.

⁴ Act, Par. 2, lines 47–48 (*infra* Appx. I).

⁵ It has been held that a tax on the “capital” of incorporated and private bankers does not include deposits and money temporarily borrowed: *Bailey v. Clark*, 21 Wall. 284. On the other hand, it does include profits accumulated and retained throughout a period of years as part of the company’s working capital, though carried on its books under the head of “profit and loss”: *Leather Mfrs. Nat. Bank v. Treat*, 128 Fed. 262; 62 C. C. A. 644.

New York has taxed the “capital employed” by corpo-

in this country? Of course, land in the United States owned by a foreign company is capital invested in this country. So also, tangible personal property permanently located in America probably falls within the same category. The difficulty arises with respect to intangible property.

When a foreign corporation owns shares in a domestic company, can it be said that the shares so owned constitute "capital invested in the United States." ¹ This question is immaterial; because the domestic company would be liable to the tax, and therefore income derived by the

rations within the state: *New York State v. Roberts*, 171 U. S. 658; 19 Sup. Ct. Rep. 58. These words in the New York statute have been construed in the following cases, among others: *People v. Campbell*, 138 N. Y. 543; 34 N. E. 370; 20 L. R. A. 453; *People v. Wemple*, 148 N. Y. 690; 43 N. E. 176; *People v. Wemple*, 133 N. Y. 323; *People v. Am. Bell Tel. Co.*, 117 N. Y. 241; 22 N. E. 1057. But the New York cases decided under this statute expressly draw a distinction between "capital employed" in the state and capital which is merely "invested" therein. *People ex rel. Wall. etc. Co. v. Miller*, 181 N. Y. 328, 331; *People ex rel. Fort George Realty Co. v. Miller*, 179 N. Y. 49, 52-53; *People ex rel. Singer Mfg. Co. v. Wemple*, 150 N. Y. 46, 49; *People ex rel. Niagara etc. Co. v. Roberts*, 30 N. Y. App. Div. 180, 182, affirmed on opinion below, 157 N. Y. 676. Hence, New York cases decided under that statute bear only indirectly upon the construction of the words "capital invested" in the federal law.

¹ Cf. *People v. Campbell*, 138 N. Y. 543; 34 N. E. 370; 20 L. R. A. 453; *People v. Wemple*, 148 N. Y. 690; 43 N. E. 176; *People v. Am. Bell Tel. Co.*, 117 N. Y. 241; 22 N. E. 1057.

foreign company from its shares would be exempt, even though those shares should be held to be capital invested in the United States.

But suppose a foreign company holds a mortgage upon land or tangible personal property situated in this country. For example, suppose a foreign corporation holds mortgage bonds of a domestic company, can it be said that these bonds represent capital invested in this country? ¹ The problem is not easy of solution. If the domestic company is also transacting business abroad, and if the bonds are secured by mortgage of its foreign property as well as of its property situated in this country, the question becomes still more complex.

It seems that bonds deposited by a foreign insurance company with a state official to secure local policy-holders are capital of the company in that state.²

§ 79. Deductions from Gross Income by Foreign Companies — In General. — The deductions expressly directed to be made are the same as in the case of domestic companies, with certain differences arising out of an attempt by Congress to apportion the company's expenses between its business in this country and in its own domicile.

¹ Cf. *People v. Campbell*, 138 N. Y. 543; 34 N. E. 370; 20 L. R. A. 453 (bonds of a foreign corporation owned by a New York company and presumed to be at its home office, held to be taxable to the New York company as "capital employed" in New York).

² *Scottish Union etc. Ins. Co. v. Bowland*, 196 U. S. 611, 630.

§ 80. **Operating Expenses of Foreign Companies.** — With respect to what thus may be deducted as operating expenses, the rules prescribed by the Act¹ are almost word for word the same as those with respect to domestic companies,² except that they are confined to the operation and maintenance of business and property within the United States. Two verbal variations, — namely, the use of the word property in the singular instead of the plural number, and the substitution of “earnings” for “income,” in the expression “paid out of income,” — have been already considered and shown to be immaterial.³ As we have just considered the meaning of “business transacted” and “capital invested” in the United States, this class of deductions calls for little further comment. In the corresponding clause with respect to the return required to be made by foreign companies, the Act, apparently, *per incuriam*, omits the word “property,”⁴ so that foreign companies are not *required* to state in their return the expense of maintaining their property in this country; but as they are entitled to a deduction therefor, they should certainly be *permitted* to do so.

§ 81. **Losses by Foreign Companies.** — The clause respecting deductions for losses by foreign

¹ Act, Par. 2, lines 50–58 (*infra* Appx. I).

² As to which see *supra* § 46–§ 52.

³ *Supra* § 48 and § 50.

⁴ See *infra* § 96.

companies ¹ is confined, so far as express language goes, to losses sustained in "business conducted" ² in the United States, and does not expressly include losses of capital invested in this country. It would seem, however, that this omission is an inadvertence, for if the foreign company is to be taxed on income derived from capital invested in this country, there would be no justice in refusing to it the privilege which is allowed to domestic companies, of deducting from income received the amount of invested capital lost. This conclusion is fortified by the express provision applicable to foreign as well as to domestic companies, that losses shall include "a reasonable allowance for depreciation of property, if any." ³ Although this expression must be confined by construction to losses by depreciation of property situated in this country, it would seem to be broad enough to include losses of invested capital as well as losses in business. In all other respects, the clause respecting deductions for losses is word for word the same as the corresponding clause applicable to domestic companies.⁴ The provisions as to deductions by insurance companies ⁵

¹ Act, Par. 2, lines 58-69 (*infra* Appx. I).

² As to what is a loss in a given business, as distinguished from a loss in another business conducted by the same individual, compare *Brown v. Watt*, 50 J. P. 583.

³ Act, Par. 2, lines 63-65 (*infra* Appx. I).

⁴ As to the construction of which see *supra*, § 53-§ 57.

⁵ Act, Par. 2, lines 65-69 (*infra* Appx. I). Cf. *supra* § 58, § 59.

for sums other than dividends paid within the year on policy and annuity contracts, and for additions required by law to be made to reserve funds, is not expressly confined to losses incurred in policies written in the United States, or to additions to reserve funds required to be made by the laws of the United States or any of them; but such will probably, — and rightly, — be its construction.

It has been held in England that damages paid by a brewing company to a customer in an inn, which was carried on by a manager as part of the company's business, for damages sustained in consequence of negligence of a servant, is not a loss "connected with or arising out of the company's trade."¹

§ 82. Interest on Indebtedness Paid by Foreign Companies. — The clause respecting deductions for interest paid by the foreign company on its bonded and other indebtedness² is the same as the corresponding provision with respect to domestic companies,³ except that the limit of the amount of indebtedness interest paid upon which may be deducted, instead of being the total amount of outstanding paid-up capital stock of the company, as in the case of domestic companies, is an amount "not exceeding the proportion of its paid-up capital stock outstanding at the close

¹ *Strong & Co. v. Woodfield* (1906), A. C. 448.

² Act, Par. 2, lines 70-81 (*infra* Appx. I).

³ As to which, see *supra* § 60-§ 67.

of the year which the gross amount of its income for the year from business transacted and capital invested in the United States and any of its Territories, Alaska, and the District of Columbia, bears to the gross amount of its income derived from all sources within and without the United States;” and except that foreign banking companies, if there be any such doing business in the United States, are not allowed to deduct interest paid on their deposits in excess of the limit of indebtedness as just stated.¹

It will be observed that this indebtedness, interest upon which may, if paid within the year, be deducted from the gross income of foreign companies from business transacted and capital invested in the United States, is not confined to debts contracted in the course of the business carried on in this country. But the fact that the limit is fixed by the proportion between the income received from American business and property, and its total income from all sources, casts upon it, as will presently be more fully explained, the heavy burden of making a return of the total amount of its income from all sources. It is submitted that this is an unjust burden to put upon foreign companies, and that the law ought to be amended so as to obviate the necessity for it.

§ 83. Taxes Paid by Foreign Companies.—With respect to the deduction for taxes, the pro-

¹ Act, Par. 2, lines 71–81 (*infra* Appx. I).

vision ¹ is the same as that applicable to domestic companies, except that it is confined to "taxes imposed under the authority of the United States or of any State or Territory thereof," and does not include any taxes whatsoever imposed by the laws of any foreign country. In all other respects the same considerations stated above with reference to domestic companies are applicable.²

§ 84. **Dividends on Shares in Other Companies held by Foreign Corporations.** — As to deductions for dividends received by the company within the year on stock of other companies,³ the provision is in all respects precisely identical with the corresponding provision as to domestic companies, and should therefore receive the same interpretation.⁴

§ 84A. **For what Period Income is Calculated.** — Throughout the First and Second Paragraphs, the Act repeatedly uses the expression "within the year," and other equivalent words. Every company shall be subject to pay "annually" ⁵ the tax in question, equivalent to one per cent of its net income "during such year" ; ⁶ and that income is to be ascertained by taking the gross income received "within the year," ⁷ and deducting

¹ Act, Par. 2, lines 81-84 (*infra* Appx. I).

² *Supra* § 68, § 69.

³ Act, Par. 2, lines 85-89 (*infra* Appx. I).

⁴ As to which, see *supra* § 71-§ 74.

⁵ Act, Par. 1, line 13 (*infra* Appx. I).

⁶ Act, Par. 1, lines 19-20 and line 30 (*infra* Appx. I).

⁷ Act, Par. 2, line 5, lines 46-47 (*infra* Appx. I).

therefrom certain expenses incurred "within the year."¹ But nowhere in those two paragraphs does it appear when the year is to begin and end. This appears for the first time in the Third Paragraph,² at the commencement of which it is stated that the tax is to be computed for the first year on the income of the year ending December 31st, 1909,³ and so on for each calendar year thereafter.

¹ Act, Par. 2, lines 7, 13, 18, 20-21, 22, 30, 31-32, 37, 51, 59, 66-67, 69, 70, 82, 85-86 (infra Appx. I). Note also the recurring expression "at the close of the year." Act, lines 27-28, 74-75.

² Act, Par. 3, lines 10-12 (infra Appx. I).

³ As to whether this includes the portion of the year which had elapsed when the Act took effect, see *supra* § 29, § 39.

CHAPTER V

THE RETURN

- § 85 Importance.
- § 86 When to be made.
- § 87 By what companies to be made.
- § 88 By whom and how to be sworn to.
- § 89 To whom to be made.
- § 90 Control of Commissioner of Internal Revenue over.
- §§ 91-100 What the return should contain.
- § 91 Amount of capital stock.
- § 92 Amount of indebtedness.
- § 93 Gross income.
- § 94 Dividends received from other companies.
- §§ 95-99 Amount claimed as deductions.
- § 95 In general.
- § 96 (1) Expenses of maintenance and operation, etc.
- § 97 (2) Losses sustained.
- § 98 (3) Interest paid on indebtedness.
- § 99 (4) Taxes paid.
- § 99A Net income.
- § 100 Additional matters not required by the Act to be stated.
- § 101 Duty of company where an accurate return is impossible.
- § 102 Disposition of the return.
- § 103 Effect of the return.
- § 104 Failure to make return.
- § 105 Returns incomplete on their face.

- §§ 106-114 Correcting the return.
- § 106 Preliminary proceedings before Commissioner of Internal Revenue.
- § 107 Further proceedings — requiring additional information from the company.
- § 108 Examination of books and taking of testimony.
- § 109 Court proceedings.
- § 110 Defences.
- § 111 Costs.
- § 112 Decision of Commissioner on evidence so acquired.
- § 113 Period of limitations.
- § 114 Correcting return by action of debt for taxes due.
- § 115 Penalties for erroneous returns.
- § 116 Returns as public records.
- § 117 Protection against disclosure of secrets.
- § 118 Returns not affected by other statutes.

§ 85. **Importance.** — Nothing connected with the Act is more important than the matter of the preparation and correction of the return. For while the amount of the tax is not very heavy, being only one per cent of the net income in excess of five thousand dollars, yet the fact that the return is required to state, as matter of public record open to inspection by all comers, many facts in regard to the business which most purely private corporations would be very loth to reveal, and the further fact that the correction of the return may involve an inquisitorial inspection of the company's books and examination of its officers, and that the President may direct all the information so acquired to be published, — these facts make the law very onerous.

§ 86. **When to be Made.** — The return is re-

quired to be made on or before the first day of March in each year.¹ The companies subject to the tax must at their peril inform themselves of this fact. It is not made the duty of any government officer or employee to give them notice, or to warn them of their obligation, or to furnish them with forms, blanks, or instructions for their guidance in making up the returns; and failure to receive the usual blanks is no excuse for failing to make the return.² In case of the absence or illness of an officer, or for any other good reason, the collector may allow such further time, not exceeding thirty days, after March 1st, as he may think proper.³

§ 87. **By What Companies to be Made.** — A return must be made by every corporation "subject to the tax."⁴ It seems that these words include all companies which would be liable to the tax if their income were sufficient; and therefore include companies whose net income is less than five thousand dollars a year or whose net income is derived from exempted sources.⁵ Such at least is the interpretation of the Act by the Commissioner of Internal Revenue.⁶

§ 88. **By Whom and How to be Sworn to.** —

¹ Act, Par. 3, lines 12-15 (*infra* Appx. I).

² U. S. Int. Rev. Regs. No. 31, Dec. 3d, 1909, Art. 6 (*infra* Appx. II).

³ Act, Par. 5, lines 8-16.

⁴ Act, Par. 3, lines 20-21 (*infra* Appx. I).

⁵ See *supra* § 72, § 73.

⁶ U. S. Int. Rev. Regs. No. 31, Dec. 3d, 1909, Art. 1 (*infra* Appx. II).

The return is required to be sworn to by the "president, vice-president or other principal officer" of the company, and also by its "treasurer or assistant treasurer."¹ Any person performing the duties of a treasurer would probably be deemed a treasurer *quoad hoc*. Doubtless, it is sufficient for the officers mentioned to make oath to the best of their knowledge, information and belief;² for since the Act specifies the officers who are to swear to the report and does not require that it shall be sworn to by a person having personal knowledge of the facts stated therein, no other rule would be possible.

The Act does not specify the officers by whom the oath is to be administered. It may, therefore, be administered by any officer empowered to do so by general law — a clerk or deputy clerk of a United States Court or a United States Commissioner,³ or by a notary public,⁴ or by the collector or deputy collector.⁵

¹ Act, Par. 3, lines 15-18 (infra Appx. I).

² The form of oath may be prescribed by the Secretary of the Treasury. See Rev. Stats. § 251 (1 U. S. Comp. Stats. p. 138), and infra § 128. The affidavits appended to the printed forms of returns sent out by the Treasury Department are to be made to the best of the affiant's "knowledge and belief and from such information as he has been able to obtain." See infra Appx. III.

³ Act March 2, 1901, c. 814, amending Act May 28, 1896, c. 252, § 19 (1 U. S. Comp. Stats. 499).

⁴ Act Aug. 15, 1876, c. 304 (1 U. S. Comp. Stats. 662-663).

⁵ Rev. Stats. § 3165 (2 U. S. Comp. Stats. p. 2057), infra § 130.

§ 89. **To Whom to be Made.** — The return must be made to the collector of internal revenue for the revenue district in which the company in question has its "principal place of business,"¹ or in the case of a foreign company to the collector of the district in which is situated "the place where its principal business is carried on in the United States."² In the case of domestic companies, does "principal place of business" refer to its home office, or place designated in its charter or incorporation paper as its chief office or place of business, or to the place where in fact its most important business may be transacted? The question is not, theoretically, easy of solution;³ but in practice nobody is likely to complain because the return is made to the collector of a wrong district.

§ 90. **Control of Commissioner of Internal Revenue over.** — The return must be "in such form as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe."⁴ This is the only power vested in the Commissioner of Internal Revenue or in the Secretary of the Treasury in connection with the original preparation of the return. It is important to emphasize the fact that the power does not extend to any direction as to the *substance*

¹ Act, Par. 3, lines 21-25 (*infra* Appx. I).

² Act, Par. 3, lines 25-30 (*infra* Appx. I).

³ Cf. 1 Machen, *Mod. Law of Corps.* § 114.

⁴ Act, Par. 3, lines 30-33 (*infra* Appx. I).

of the return or its contents, but is strictly confined to form.¹ The Commissioner may require the return to be on paper of a certain size or quality, to be printed or typewritten, to be in numbered paragraphs, or to be upon blank forms to be supplied by the Treasury Department. All such matters are within his power.² But he has no authority to order the return to set out any matter not required by the Act of Congress to be stated therein. He cannot lawfully require any more detailed information than the legislature has commanded the company to furnish him.³

¹ Under some other statutes, the Commissioner is authorized to prescribe the contents as well as the form of the returns: *United States v. Lamson*, 165 Fed. 80.

² Power to prescribe "form" of administration bonds includes power to require from co-executors either a joint bond or several bonds. *Chamberlain v. Anthony*, 21 R. I. 331.

³ Cf. *Morrill v. Jones*, 106 U. S. 466; 1 Sup. Ct. Rep. 423 ("The Secretary of the Treasury cannot by his regulations alter or amend a revenue law"); *United States v. Two Hundred Barrels of Whiskey*, 95 U. S. 571; *Spreckels Sugar Ref. Co. v. McClain*, 113 Fed. 244; 51 C. C. A. 201 (reversed on other points, 192 U. S. 397; 24 Sup. Ct. Rep. 376); *United States v. Lamson*, 165 Fed. 80 (doubting whether under a statute providing that dealers in oleomargarine shall keep such books and render such returns in relation thereto as the Commissioner may prescribe, he may require the return to be under oath); *United States v. Eaton*, 144 U. S. 677 (holding that a person who fails to comply with a treasury regulation is not punishable criminally under a statute for omitting to do anything "re-

§ 91. **What the Return Should Contain — Amount of Capital Stock.** — We proceed, therefore, to an examination of the statutory provisions as to what the return must state. Except where a difference is specially noted, the requirements for returns by foreign companies are the same as those for domestic companies.

In the first place, it must state "the total amount of the paid-up capital stock" of the company "outstanding at the close of the year."¹ The meaning of the same words in a similar connection in the Second Paragraph have been fully considered above,² and it is sufficient to refer to that discussion without repeating what was there said. This requirement cannot be applied to mutual insurance companies; for although they are subject to the tax, yet they have no capital stock, so that it must be sufficient to state that fact.³

quired by law" to be done, even if the regulation is authorized by law); *United States v. Hyams*, 146 Fed. 15.

But see *Powell v. United States*, 135 Fed. 881 (regulations of Commissioner as to rebate of taxes on manufactured tobacco held not void as unreasonable); *Thacher v. United States*, 15 Blatch. 15 (regulation of Commissioner held valid under Rev. Stats. § 321, and § 3249); *United States v. Lamson*, 173 Fed. 673 (regulations of Commissioner as to keeping books and making returns of oleomargarine, requiring names and addresses of purchasers, held not unreasonable under the broad terms of the Oleomargarine Act).

¹ Act, Par. 3, lines 33-37 (infra Appendix I).

² *Supra* § 61-§ 63.

³ Cf. *supra* § 64.

§ 92. **Amount of Indebtedness.** — Secondly, the return must state “ the total amount of the bonded and other indebtedness ” of the company “ at the close of the year.”¹ What is meant by “ other indebtedness ” has been explained above.²

§ 93. **Gross Income.** — Thirdly, if the company be a domestic company, it is required to set out in the return “ the gross amount of its income received during such year from all sources.”³ A foreign company is required to state the “ gross amount of its income received within the year from business transacted and capital invested within the United States ”;⁴ but is also like domestic companies required to state the amount of its gross income derived from all sources, for that amount may be material in estimating the amount of deduction to which it is entitled for interest paid during the year on its indebtedness.⁵

§ 94. **Dividends Received from Other Companies.** — The return must also state, in the case of either a domestic or a foreign company, the amount received within the year by way of dividends upon stock of other companies subject to the tax.⁶ The Paragraph relating to the return groups the statement of the amount of such

¹ Act, Par. 3, lines 37-40 (infra Appx. I).

² Supra § 60.

³ Act, Par. 3, lines 41-44 (infra Appx. I).

⁴ Act, Par. 3, lines 44-50 (infra Appx. I).

⁵ Supra § 82.

⁶ Act, Par. 3, lines 50-56 (infra Appx. I).

dividends with the statement of the amount of gross income, although the preceding Paragraph of the Act classes such dividends as the fifth class of deductions. At any rate, the question what the company is entitled to treat as included within such dividends is discussed above.¹

§ 95. **Amount Claimed as Deductions — In General.** — The Act further requires that the return shall state the amount claimed as deductions under the several heads mentioned in the Second Paragraph of the Act, which are repeated almost verbatim in this Third Paragraph.² They fall under four heads.

§ 96. (1) “**The Total Amount of all the Ordinary and Necessary Expenses Actually Paid Out of Earnings in the Maintenance and Operation of the Business and Properties of Such Corporation, Joint Stock Company or Association, or Insurance Company within the Year, Stating Separately all Charges Such as Rentals or Franchise Payments Required to be made as a Condition to the Continued Use or Possession of Property, and if Organized under the Laws of a Foreign Country the Amount so Paid in the Maintenance and Operation of its Business within the United States and its Territories, Alaska and the District of Columbia.**”³ — For an explanation of the items which the company may properly claim as deductions under

¹ Supra § 71-§ 74.

² Act, Par. 3, lines 56-123 (infra Appx. I).

³ Act, Par. 3, lines 56-70.

this head, reference is made to the exposition of the corresponding clauses in the preceding paragraph of the Act.¹

The words "within the year" are transposed in this clause; and if it stood alone, they might perhaps be read in connection with "operation" and "maintenance," so as to require the company to state the amounts paid for operating the business during the year, instead of the amounts paid within the year for expenses of operation or maintenance though incurred at some previous time. But in the corresponding clauses in the Second Paragraph the words "within the year" follow immediately after "paid,"² so that the latter construction is, as above stated, demonstrated to be correct.³

As to foreign companies the Paragraph omits, probably through inadvertence, the word "property," so that a foreign company is not *required* to state the amount expended in maintenance of its property, or capital invested, within the United States, but merely the amount expended for the maintenance of its business. But since, under the Second Paragraph, a foreign company is expressly declared to be entitled to deduct from its gross income the amount expended for the maintenance of its American property or investments as well

¹ Supra § 46-§ 52.

² Act, Par. 2, lines 6-9 (infra Appx. I).

³ See supra § 47.

as for the maintenance of its American business,¹ every foreign corporation subject to the Act will be inclined to make the statement voluntarily so as to get the benefit of the larger deduction.

According to the letter of the statute, foreign companies are required to state both the amount expended for maintenance of their business in this country and the total amount expended for maintenance both at home and abroad. The latter amount is irrelevant, and there is no reason for requiring a foreign corporation to set it out in its return. To do so would be to impose a quite gratuitous burden.

§ 97. (2) "The Total Amount of all Losses Actually Sustained during the Year and not Compensated by Insurance or Otherwise, Stating Separately any Amounts Allowed for Depreciation of Property, and in the case of Insurance Companies the Sums other than Dividends, paid within the Year on Policy and Annuity Contracts and the Net Addition, if any, Required by Law to be made within the Year to Reserve Funds; and in the Case of a Corporation, Joint Stock Company or Association, or Insurance Company, Organized under the Laws of a Foreign Country, all Losses Actually Sustained by it during the Year in Business Conducted by it within the United States or its Territories, Alaska, and the District of Columbia, not Compensated by Insurance or Otherwise, Stating

¹ Act, Par. 2, lines 50-55 (*infra* Appx. I). See also *supra* § 80.

Separately any Amounts Allowed for Depreciation of Property, and in the Case of Insurance Companies the Sums other than Dividends, Paid within the Year on Policy and Annuity Contracts and the Net Addition, if any, Required by Law to be made within the Year to Reserve Fund.”¹ — For a statement of the various items which a corporation may justly claim as deductions under this head reference is made to the explanation of the parallel clauses in the Second Paragraph of the Act.²

It is to be observed that the return must state *separately* the amounts claimed as an allowance on account of depreciation of property,³ and the amounts of the special allowances to insurance companies.⁴

The letter of the clause would require foreign companies to state the total amount of their losses both within and without the United States; but as losses occurring in business transacted outside the United States are irrelevant, the officials charged with the administration of the law will hardly exact literal compliance with this provision by foreign companies.

§ 98. (3) “The Amount of Interest Actually Paid within the Year on its Bonded or Other Indebtedness not Exceeding the Paid-up Capital Stock

¹ Act, Par. 3, lines 70–93.

² Supra § 53–§ 59, as to domestic companies, and § 81 as to foreign companies.

³ As to which, see supra § 57.

⁴ As to which see supra § 58–§ 59.

of such Corporation, Joint Stock Company or Association, or Insurance Company, Outstanding at the Close of the Year, and in the Case of a Bank, Banking Association, or Trust Company, Stating Separately all Interest Paid by it within the Year on Deposits; or in the Case of a Corporation, Joint Stock Company or Association, or Insurance Company, Organized under the Laws of a Foreign Country, Interest so Paid on its Bonded or other Indebtedness to an Amount of such Bonded and other Indebtedness not Exceeding the Proportion of its Paid-up Capital Stock Outstanding at the Close of the Year, which the Gross Amount of its Income for the Year from Business Transacted and Capital Invested within the United States and any of its Territories, Alaska, and the District of Columbia, Bears to the Gross Amount of its Income Derived from all Sources within and without the United States.”¹—The various items justly claimable as deductions under this head have been fully explained above.²

It should be noted that banks and trust companies must state separately³ the amount of interest paid within the year on deposits. Note also that the expression is “interest paid by it within the year on deposits”⁴ and not “interest

¹ Act, Par. 3, lines 93–117 (infra Appx. I).

² Supra § 60–§67, as to domestic companies, and § 82, as to foreign companies.

³ Act, Par. 3, lines 101–103 (infra Appx. I).

⁴ Act, Par. 3, lines 102–103 (infra Appx. I).

actually paid by it within the year" as in the corresponding clause in Paragraph Two.¹

§ 99. (4) **"The Amount Paid by it"** — i. e. the company making the return — **"Within the Year for Taxes Imposed under the Authority of the United States or any State or Territory Thereof, and Separately the Amount so Paid by it for Taxes Imposed by the Government of any Foreign Country as a Condition to Carrying on Business Therein."**² — The items which may be legally included under this head are set forth above.³

It should be noted that foreign taxes must be stated separately. This is very necessary because although the Act, literally construed, requires foreign companies as well as domestic companies to state the amount of taxes paid by them to foreign governments as a condition to carrying on business in their territories, yet amounts paid for such taxes can be deducted from the gross income only in the case of domestic companies.

§ 99A. **Net Income.** — Finally, the return must state "the net income of such corporation, joint stock company or association, or insurance company, after making the deductions in this section authorized."⁴ Observe that the amount to be

¹ Act, Par. 2, lines 29-30. See *supra* § 67, and compare § 49.

² Act, Par. 3, lines 117-123 (*infra* Appx. I).

³ *Supra* § 68-§70, as to domestic companies, and § 83, as to foreign companies.

⁴ Act, Par. 3, lines 123-127 (*infra* Appx. I).

stated is the net income after making the deductions authorized, not simply in the Third Paragraph, but anywhere in the Section or in other words anywhere in the law which imposes this tax; for the whole of that law is comprised in Section 38 of Chapter 6 of the Acts of the Sixty-first Congress, 1st Session.¹ Consequently, there is nothing in this provision to prove that the only deductions allowable to be made from the gross income are those specifically directed in the second and third paragraphs of the Thirty-eighth section.

§ 100. **Additional Matters not Required by the Act to be Stated.** — The company may in its return voluntarily state additional facts over and above those required by law to be stated. This may often be quite proper, in order to explain the return. At all events, a return cannot be deemed faulty because it may state *more* than is required. At the worst, the additional matter may be rejected as surplusage.

But as indicated above, neither the Commissioner of Internal Revenue nor the Secretary of the Treasury has any power to compel a company to state in its return anything over and above what is required by Congress. Nevertheless, the published Regulations of the Commissioner undertake to require the various corporations to submit with their returns a supplemental statement or inventory of materials, supplies and merchandise on hand for

¹ *Supra* § 2.

sale or use at the beginning of the year.¹ Yet it is submitted that this order is clearly *ultra vires*. No authority to make any such requirement is conferred upon the Commissioner either by this Act or by any other Act of Congress; but on the contrary this statute by prescribing in detail precisely what the company shall be obliged to state in the return necessarily implies that it shall not be required to state anything further. The power of the Commissioner is merely to prescribe the *form* of the return.²

The Commissioner has no authority to compel the company to disclose how it arrives at the results stated in the return. Its full duty is done when its officers make the statutory declaration under the penalty of perjury and the additional penalties imposed by this statute in case of a false and fraudulent return.

§ 101. **Duty of Company where an Accurate Return is Impossible.**—It may often happen that a corporation is unable to ascertain accurately, either on account of the manner in which its books are kept or from some other cause, the matters which the Statute requires to be set out in the return. In such circumstances, the company must answer the statutory interrogatories as best it may. If it is honestly unable to ascertain accurately the data which the Statute compels to be

¹ U. S. Int. Rev. Regs., No. 31, Dec. 3d, 1909, Art. 5 (*infra* Appx. II).

² See *supra* § 90.

disclosed, it is entitled to make a *bona fide* guess. Needless to say, there is little danger that any such guess will err on the side of unfairness to the company. To be sure, the Act provides that each company shall make "a true and accurate return."¹ But this can only mean a return as accurate as possible from the information in the company's possession.

Not only is this true as to past transactions; but even for the future the corporations are under no obligation to change their method of book-keeping so that the taxable net income may be more easily and accurately ascertained.² The Income Tax Law of 1894 did contain a direction that every company doing business for profit should "keep full regular and accurate books of account;"³ but no such provision is contained in

¹ Act, Par. 3, lines 14-15 (infra Appx. I).

² Of course, a company which fails to keep its books so as accurately to show the amount of net income calculated in the statutory mode takes the risk of being compelled to pay an excessive amount, if proceedings to examine its books are instituted and if the Commissioner of Internal Revenue finds himself obliged to guess or estimate the company's net income. His guess is not so likely to be favorable to the company as the guess of its own officers. An assessment based on a mere estimate would be lawful: *United States v. U. S. Fidelity & Guaranty Co.*, 144 Fed. 866, reversed on another point, 158 Fed. 604.

³ Act, Aug. 27, 1894, c. 349, § 36; 2 U. S. Comp. Stats. 2267. A similar requirement is imposed upon dealers in oleomargarine by the oleomargarine-tax laws. See Act, May

the present law, and the power to enact it is vested in Congress and not in the Commissioner.¹ Nevertheless, that official appears to be of a contrary opinion; for he has promulgated a regulation that "the business transacted by corporations, joint stock companies, associations or insurance companies must be so recorded that each and every item therein set forth may be readily verified by an examination of the books and accounts, where such an examination is deemed necessary,"² although he also announces that "no particular system of bookkeeping or accounting will be required by the Department."³

§ 102. **Disposition of the Return.** — The Act provides that the collector, immediately after receiving a return, shall transmit it to the Commissioner of Internal Revenue,⁴ in whose office the same shall be permanently kept.⁵

9, 1902, c. 784, § 6 (U. S. Comp. Stats., 1909, p. 868), construed in *United States v. Lamson*, 173 Fed. 673.

¹ Cf. *supra* § 90. But see *United States v. Eaton*, 144 U. S. 677 (leaving undecided the question whether a regulation requiring dealers in oleomargarine to keep books, and make a monthly return was authorized under a provision empowering the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury to make "all needful regulations for carrying into effect a law taxing oleomargarine").

² U. S. Int. Rev. Regs., No. 31, Dec. 3d, 1909, Art. 6 (*infra* Appx. II).

³ *Ibid.*

⁴ Act, Par. 3, lines 127-129 (*infra* Appx. I).

⁵ Act, Par. 6 (*infra* Appx. I). See *infra* § 116.

§ 103. **Effect of the Return.** — Unless the return shall be corrected in the mode provided in the Act and hereinafter explained, it stands as correct and unimpeachable. The Statute enacts that “ All returns shall be retained by the Commissioner of Internal Revenue, who shall make assessments *thereon*.” ¹ The assessment shall be made *thereon* — that is, on the facts as stated in the return. The duty of the Commissioner in this regard is little if anything more than ministerial. He is merely to see that the process of subtracting the various items of deduction from the gross income as set out in the return is correctly performed,² and to make an assessment of one per cent of the balance.³

§ 104. **Failure to make Return.** — The failure to make a return within the time limited in the Act ⁴ renders the corporation liable to a fine of not less than one thousand dollars and not more than ten thousand dollars.⁵ In case of the failure of any company to make a return as required by law, it is the duty of the collector to report that fact to the Commissioner of Internal Revenue who shall thereupon require such information from the company as he may deem expedient and may specially designate one of the government

¹ Act, Par. 5, lines 1–3 (*infra* Appx. I).

² See *infra* § 120.

³ See *infra* § 121, § 134.

⁴ As to what the time so limited is, see *supra* § 86.

⁵ Act, Par. 8, lines 1–5 (*infra* Appx. I).

officers or employees known as revenue agents¹ to investigate the matter.² Thenceforth the proceedings do not differ from the proceedings, which are fully explained below, for the correction of a defective return. In brief, upon the evidence reported by the revenue agent, the Commissioner is himself to prepare a return on behalf of the delinquent company.³ The return so prepared is to have the same effect as a return duly made by the company would have done, and upon the return so prepared the assessment is to be made.

§ 105. **Returns Incomplete on Their Face.** — It would seem, although the statute does not so declare in words, that a return which on its face fails to comply with law — that is to say, omits some of the information required by law to be given — may be rejected by the collector, and regarded as no return at all, at least as to the omitted matters.⁴ He may, accordingly, report that no return has been made, and the Commissioner may thereupon institute the proceedings above referred to for supplying the return. A

¹ As to whom, see Rev. Stats. § 3152, amended by Act March 1st, 1879, c. 125, § 2 (U. S. Comp. Stats. p. 2047).

² Act, Par. 4, lines 7-39 (infra Appx. I).

³ Act, Par. 4, lines 40-43 (infra Appx. I).

⁴ Cf. *Attorney-General v. Till* (Ho. of Lds.), 54 Sol. J. 132, reversing (1909) 1 K. B. 694 (where it had been held that a statute which imposed a penalty upon any person who refuses or neglects to deliver a "statement as aforesaid" of his income does not apply to a person who mistakenly makes an erroneous return).

return which is incomplete on its face differs from a return which, though fair on its face, is false or incorrect in some particulars.

§ 106. **Correcting the Return — Preliminary Proceeding before Commissioner.** — As stated above, a return which on its face complies with law is presumed to be correct until impeached in the mode provided by the Act. The first step in the statutory proceeding to impeach its correctness is to satisfy the Commissioner of Internal Revenue that the return is false. "Whenever," says the Act, "evidence shall be produced before the Commissioner of Internal Revenue which in the opinion of the Commissioner justifies the belief that the return made by any corporation, joint stock company or association, or insurance company, is incorrect,"¹ the Commissioner may proceed to correct the return in a manner specified in the Act. The statute is silent as to how or by whom this evidence that the return is incorrect is to be adduced. There is no provision for notice to the company; and doubtless this preliminary proceeding is intended to be purely *ex parte*. There is no provision for compelling the attendance of witnesses. The "evidence" referred to must, therefore, be produced voluntarily. Doubtless any patriotic, not to say officious, citizen might testify to the Commissioner that a return is false. The President, or any officer of the government, might very properly lay before the

¹ Act, Par. 4, lines 1-7 (*infra* Appx. I).

Commissioner any facts tending to show the incorrectness of a return. It is expressly made the duty of the several collectors, in the general statute defining their duties, to report any such facts which they may happen to learn.¹

In passing upon the sufficiency of any evidence adduced for this purpose, the Commissioner is exercising a quasi-judicial function and is not acting in a ministerial capacity as in making up the assessment on the returns.² No court, therefore, would undertake to control his discretion in determining the evidence to be either sufficient or insufficient. But *some* evidence tending to show the return to be incorrect there must be, or else the Commissioner has no jurisdiction to proceed further for the correction of a return which is fair on its face. It is not necessary to assert that the Commissioner is bound by all the technical rules of evidence applicable to trials at *nisi prius*; but there must be some facts shown sufficient to justify a rational man in believing the return to be incorrect — something more than mere suspicion.

As the Commissioner in this matter acts in a quasi-judicial capacity, and not in a merely ministerial capacity, it follows that he cannot delegate to anybody else the duty of passing on the evidence. Until he, personally, is satisfied that the "evidence produced" before him justifies

¹ Rev. Stats. § 3163 (2 U. S. Comp. Stats. p. 2056); Rev. Stats. § 3172 (2 U. S. Comp. Stats. p. 2065).

² As to which, see *supra* § 103 and *infra* § 120.

the belief that a return is incorrect, he has no jurisdiction to take any further steps for its correction.¹

The Commissioner seems to have overlooked the necessity for some *ex parte* but quasi-judicial proceedings before instituting any proceedings for correction of the return; for his published regulations intimate that, on the mere request of a collector, a revenue agent will be specially designated to collect data in order to determine the amount of tax to be assessed.²

§ 107. **Further Proceedings — Requiring Additional Information from the Company.** — Whenever the Commissioner decides that the evidence presented to him justifies the belief that the return is incorrect, the Act then provides that he “*may* require from the corporation, joint stock company or association, or insurance company, making such return, such further information with reference to its capital, income, losses, and expenditures as he may deem expedient.”³ Probably “*may*” in this clause should be construed as “*shall*”; for this provision is the only one that implies any notice to the company of the proceeding for correction of the return, and yet unless such notice is required, the Act would seem to be

¹ As to possible remedies in case he should undertake to do so, see *infra* § 110, § 134, § 137.

² U. S. Int. Rev. Regs., No. 31, Dec. 9th, 1909, Art. 7 (*infra* Appx. II).

³ Act, Par. 4, lines 11-17 (*infra* Appx. I).

unconstitutional.¹ It is true, however, that the only persons whose testimony the revenue agent deputed by the Commissioner is authorized to take are officers and employees of the company, and it may be argued that notice to them, which is necessary in order to compel their attendance as witnesses, is sufficient notice to the company to save the constitutionality of the Act. But this argument is more specious than sound, because the company is entitled to a *hearing*, so that notice to officers and employees as witnesses hardly satisfies the constitutional requirement of notice to the company as a party or litigant.

It is to be observed that here for the first time the Act enables the Commissioner to require from the company such information as he may deem expedient. The facts which each company is obliged to disclose in the return are fixed by law, and the Commissioner has no power to add to them. But as soon as the Commissioner is satisfied by evidence adduced before him that the return is incorrect, then he may require from the company such information as he may deem expedient. He may, so to speak, cross-examine the company.

§ 108. Examination of Books and Taking of Testimony. — In addition to requiring further or more detailed information from the company

¹ *Palmer v. McMahon*, 133 U. S. 660, 669; 18 Sup. Ct. Rep. 324; *Central of Ga. Ry. Co. v. Wright*, 207 U. S. 127; *Londoner v. Denver*, 210 U. S. 373.

itself, the Commissioner of Internal Revenue, after being convinced by evidence that the return is incorrect, may specially designate one of the government employees known as revenue agents to examine any books and papers bearing upon the matters required by law to be stated in the return, and to take the testimony of officers or employees of the company with reference to those matters.¹ It is not expressly stated that the testimony shall be reduced to writing; but such is a fair inference, inasmuch as the Commissioner must act upon the information elicited.²

It is only officers and employees of the company whose testimony may be taken.³ The Act confers no authority to take the testimony of any third person, not connected with the company, or even of a private shareholder who is not an officer. Probably the words "officer or employee" would be construed as including former officers and former employees. It is not expressly stated that the books and papers which may be examined shall be confined to books and papers of the company.⁴ Yet that is the fair inference,⁵ and would seem to follow *a fortiori* from the clause which authorises the revenue agent to compel the attendance as

¹ Act, Par. 4, lines 22-34 (infra Appx. I).

² Act, Par. 4, lines 40-43 (infra Appx. I).

³ Act, Par. 4, lines 28-31 (infra Appx. I).

⁴ Act, Par. 4, lines 24-28 (infra Appx. I).

⁵ Cf. *Re Chadwick*, 1 Lowell, 439.

witnesses of officers and employees but not, so far as is stated, of any other persons.

The only books and papers which the revenue agent may examine are those "bearing upon matters required to be included in the return." He must show that a book or document contains relevant matter before he should be permitted to examine it. He is not authorised to go through the company's books and papers on a fishing expedition.

§ 109. **Court Proceedings.** — Although the revenue agent specially designated for the purpose is authorised to examine the company's books and to require the attendance of its officers or employees as witnesses, and may administer oaths to them, yet he cannot punish them if they refuse to attend as witnesses, or to permit him to examine the books.¹ In order to obviate this difficulty, the Act provides that "the Commissioner of Internal Revenue may also invoke the aid of any court of the United States having jurisdiction to require the attendance of such officers or employees and the production of such books and papers."² Another clause of the Act provides that, "Jurisdiction is hereby conferred upon the circuit and district courts of the United States

¹ It has been thought that it would be unconstitutional to punish as for contempt a refusal to obey an order of an administrative officer: *Re Kinney*, 102 Fed. 468 (headnote inadequate).

² Act, Par. 4, lines 35-39 (*infra* Appx. I).

for the district within which any person summoned under this section to appear to testify or to produce books as aforesaid, shall reside, to compel such attendance, production of books and testimony by appropriate process.”¹ It is to be observed that the power vested in the courts is not a power to punish for disobedience of the order or summons of an administrative officer, as in some similar cases under other statutes;² but is a power to issue the order or writ and to punish only for disobedience of the court’s order.

Any such court proceeding should doubtless be begun by petition in the name of the Commissioner of Internal Revenue, stating the facts and praying that appropriate process be issued. Thereupon, a summons should be issued for the officers and employees whom it is desired to examine, and some writ, or order of court, in the nature of a *subpoena duces tecum*, should be granted, directed to the officers who have custody and control of the books and documents which it is desired to examine. The matter will be governed by the rules applicable to production of documents as evidence under writs in the nature of a *subpoena duces tecum*³ rather than by the very different rules

¹ Act, Par. 8, lines 27–33 (infra Appx. I).

² Rev. Stats. § 3175 (2 U. S. Comp. Stats. p. 2068), Quære, as to the constitutionality of such a statute: *Re Kinney*, 102 Fed. 468, 468–469.

³ Cf. 2 Machen, Mod. Law of Corps., § 1092, § 1093.

applicable to the inspection of books by shareholders in the exercise of a quasi-proprietary right,¹ or the somewhat different rules applicable to the production of documents by way of discovery.² Yet, this statutory proceeding does partake somewhat of the nature of a proceeding for discovery, because only officers and employees of the company, which is the substantial though not the nominal defendant, can be summoned as witnesses. The distinction between production of books as evidence under a *subpoena duces tecum*, production by way of discovery, and production for inspection by shareholders or other persons having a quasi-proprietary right, though often overlooked, is fundamentally important.

§ 110. **Defences.** — The person summoned, either to testify or to produce books and papers, may, of course, be heard in court as to the propriety of the order, or issuance of the writ.³ If it appears that he is not an officer or employee of the company, the court under this statute has no jurisdiction to compel him to testify or to produce books or papers, and upon objection he must be excused from testifying or producing the documents; or if it is not proved or admitted that the documents in question are relevant to the matters required to be stated in the return,⁴ the court

¹ Cf. 2 Machen, Mod. Law of Corps., § 1093.

² Cf. 2 Machen, Mod. Law of Corps., § 1091.

³ Cf. *Re Kinney*, 102 Fed. 468 (headnote inadequate).

⁴ Act, Par. 4, lines 24–26 (*infra* Appx. I).

should refuse to compel their production. So, if the Commissioner of Internal Revenue has proceeded without jurisdiction — for example, has ordered the institution of proceedings for correction of the return on mere suspicion or prejudice, and without *any* evidence of its incorrectness — the court has no jurisdiction, and must quash all writs or orders for attendance of witnesses or production of books and papers.

§ 111. **Costs.** — The Act contains no provision requiring the company to pay the costs of proceedings instituted in order to correct a return, or to supply the lack of a return. Perhaps the only way the Government can be recouped for these expenses is by collecting the fines which are imposed by the Act in such cases,¹ and by the addition which is required to be made to the amount of the assessment.² It would seem unjust that costs should be imposed upon the officers or employees who may be summoned to testify.

§ 112. **Decision of Commissioner on Evidence so Acquired.** — “ Upon the information so acquired the Commissioner of Internal Revenue may amend the return or make a return where none has been made.”³ This action is to be taken by the Commissioner on the “ information so acquired ”⁴

¹ See *supra* § 104, and *infra* § 115.

² See *infra* § 121.

³ Act, Par. 4, lines 40–43 (*infra* Appx. I).

⁴ Compare the provision in the succeeding paragraph that the Commissioner shall “ make a return upon informa-

— that is, acquired from the company, its books, its officers and its employees; and he has no right to consider evidence of any other person.

Of course, the company has a right to be heard upon the matter and present its own side of the question. There is, however, no machinery provided to enable the company to compel attendance of witnesses in its behalf. Indeed, there is no provision for notice to the company, unless, as suggested above, “ may ” be construed as “ shall ” ;¹ but notice and opportunity to be heard in opposition to any change in its return is the constitutional right of the corporation and must, if necessary, be read into the law in order to save its validity.

§ 113. **Period of Limitations.** — The correction of returns, or the supplying of a return in case of a neglect to make a return, must take place “ within three years after said return is due.”² It should be observed that the provision is, not that proceedings for the correction of a false return or for supplying a lacking return shall be *instituted* within three years, but that they shall be *completed* by the actual making of the corrected return, or substitute return, within the period of three years. It is, therefore, questionable whether this provision should be construed as directory merely, or should operate as a statute of limitations so

tion obtained as above provided for.” Act, Par. 5, lines 38–39 (infra Appx. I).

¹ Supra § 107.

² Act, Par. 5, lines 36–37 (infra Appx. I).

as to bar the institution of proceedings for this purpose after the lapse of the period, and to cause the abatement of any proceedings pending at the expiration of the three years.¹

Proceedings for correcting or supplying a return may be instituted, it seems, at any time within the three years, upon discovery of the incorrectness of a return or of the lack thereof, even after the assessment has been made on the original return, has become due, and has even actually been paid.²

§ 114. **Correcting Return by Action of Debt for Tax Due.** — Under some statutes which like this Act of Congress fix the rate of tax and describe the subject, it has been held that even though no return or assessment has been made, an action of debt may be maintained by the United States to recover the proper amount of tax, which may be ascertained by evidence.³ Under such statutes it

¹ In any event, the limitation would, perhaps, not bar an action of debt to recover the amount due in excess of the assessment: *United States v. Little Miami etc. R. R. Co.*, 1 Fed. 700, reversed as to other points, *sub nom.* *Little Miami etc. R. R. Co. v. United States*, 108 U. S. 277. See *infra* § 114.

² This is the necessary force of the words "at any time" in Act, Par. 5, line 36 (*infra* Appx. I). But an assessment acquiesced in by the government may be presumed to have been correct: *United States v. Philadelphia etc. R. R. Co.*, 123 U. S. 113; 8 Sup. Ct. Rep. 77.

³ *United States v. Little Miami etc. R. R. Co.*, 1 Fed. 700, apparently affirmed as to this point, *Little Miami etc. R. R. Co. v. United States*, 108 U. S. 277, 280; *Dollar Sav.*

has also been held that an erroneous return and assessment thereof, followed by payment of the amount of the assessment, are no bar to an action of debt by the government to recover the excess claimed to have been due over and above the return and assessment.¹ Perhaps, these cases would be applied to the present law. On the other hand, although income is in most cases represented by cash, yet there may be cases where it comes in the shape of property; and in such cases, there must be a valuation before tax is imposed. It is, therefore, not clear whether the present tax is to be regarded as strictly an *ad valorem* tax, or as partaking more of the nature of a specific duty.

§ 115. **Penalties for Erroneous Returns.** — Returns which are made for the fraudulent purpose of cheating the government constitute, of course, a special class of incorrect returns. Such fraudulent returns may be corrected in the same way as other erroneous returns; the fact that a return *Bank v. United States*, 19 Wall. 227, 240; *King v. United States*, 99 U. S. 229; *Westhus v. Union Trust Co.*, 164 Fed. 795; 90 C. C. A. 441 (contra to *United States v. Marion Trust Co.*, *ubi infra*, and reviewing previous cases).

But cf. *United States v. Marion Trust Co.*, 143 Fed. 301 (holding that an *ad valorem* as distinguished from a specific tax is not "imposed" until an assessment), affirmed by a divided court, 205 U. S. 539; *Farrell v. United States*, 167 Fed. 639.

¹ *United States v. Little Miami etc. R. R. Co.*, 1 Fed. 700, reversed on another point, *Little Miami etc. R. R. Co. v. United States*, 108 U. S. 277.

is fraudulent does not make it any the less incorrect. But in addition to subjecting the company to an inquisitorial examination of its books and of its officers, for the purpose of correcting errors, a return which is fraudulent as well as false subjects the company to various penalties. In the first place, as more fully explained below, one hundred per cent is to be added to the amount of the tax.¹ This penalty is not incurred in the case of an honest mistake in a return. Secondly, in any case of a return which is either false in fact or fraudulent in purpose, the company is subjected to a fine of not less than one thousand nor more than ten thousand dollars.² It would seem that an honestly mistaken return subjects the company to this penalty, as well as a return which is both false and fraudulent.³ The language of the statute is that any company shall incur the penalty which shall render a "false or fraudulent return." But in any case of a *bona fide* mistake the government is unlikely to attempt to procure the infliction of the fine. If, however, criminal proceedings are instituted for that purpose, the company's *bona fides* is no bar to a conviction, though of course it may be considered by the court in imposing sentence. Thirdly, any person authorised by law to make or verify any return, who makes any false or fraudulent statement therein, "*with*

¹ *Infra* § 121.

² Act, Par. 8, lines 5-6 (*infra* Appx. I).

³ Cf. *infra* § 121.

intent to defeat or evade the assessment," is declared guilty of a misdemeanor, punishable by a fine of not more than one thousand dollars or imprisonment for not more than a year, or both, in the discretion of the court.¹

§ 116. **Returns as Public Records.** — After the assessment shall have been made, the returns, together with any corrections thereof made in the manner above described, are to be filed in the office of the Commissioner of Internal Revenue as public records, and shall be open to inspection as such.²

§ 117. **Protection against Disclosure of Secrets.** — Burdensome and unnecessary as the provision throwing open to public inspection the returns and corrections thereof may be thought in some quarters, there would be much more ground for complaint if all the evidence obtained in the course of a proceeding for supplying or correcting a return were given to the public. The Act provides, however, under penalty of fine and imprisonment that no "collector, deputy collector, agent, clerk or other officer or employee of the United States" shall divulge, in any manner not provided by law, any information obtained by him in the discharge of official duty, or any document received, evi-

¹ Act, Par. 8, lines 11-20 (*infra* Appx. I).

² Act, Par. 6 (*infra* Appx. I). This means that any citizen shall not merely have the right to examine them but also to make copies or extracts: *Marsh v. Sanders*, 110 La. 726; 34 So. 752.

dence taken or report made under this section "except upon the special direction of the President."¹ The general words "other officer or employee"² would be restrained by the *ejusdem generis* rule of construction to officers and employees of the same class as those specially enumerated, and therefore would not include the higher officials of the Government such as the Secretary of the Treasury and the Commissioner of Internal Revenue. The authority apparently vested in the President to authorize a disclosure of the innermost secrets of such companies as he sees fit is, like much else in modern legislation, a violation of the principle that ours should be a "government of laws and not of men."

§ 118. **Returns not Affected by Other Revenue Statutes.** — The general laws applicable to the "collection, remission and refund" of internal revenue taxes, are, so far as applicable, extended to this new tax;³ but this provision applies only to the collection of the tax after it has been assessed.⁴ It can have no reference to the making or correcting of the return, which is a matter that must precede the assessment. Indeed, it would seem by implication to exclude all internal revenue laws except those relating to the collection, remis-

¹ Act, Par. 7 (*infra* Appx. I).

² Act, Par. 7, lines 3-4 (*infra* Appx. I).

³ Act, Par. 8, lines 21-26 (*infra* Appx. I). See also *infra*, § 127, § 128.

⁴ Cf. *infra* § 129.

sion and refund of taxes — even those which, if nothing had been said in this statute, would *proprio vigore* have extended to the tax thereby imposed. For the law governing the return, we must look within the four corners of this Act.

CHAPTER VI

THE ASSESSMENT AND COLLECTION

§§ 119-122 The Assessment.

§ 119 Assessment to be made on the returns.

§ 120 Nature of Commissioner's duties.

§ 121 Amount of assessment.

§ 122 Time of assessment.

§ 123 Notice and payment of assessment.

§ 124 Payment under protest.

§§ 125-126 Collection.

§ 125 In general — distraint, etc.

§ 126 By action of debt.

§§ 127-131 Application of other internal revenue laws.

§ 127 In general.

§ 128 Powers of Secretary of Treasury.

§ 129 Powers of Commissioner of Internal Revenue.

§ 130 Powers and duty of collectors.

§ 131 Miscellaneous other provisions of internal-revenue laws.

§ 119. **The Assessment — To be made on the Returns.** — After the return is made, the next step is the levying of the assessment. This must be done by the Commissioner of Internal Revenue, on the returns,¹ either as originally made by the

¹ Act, Par. 5, lines 1-3 (infra Appx. I). See also supra §103, § 106, § 112.

companies, or as corrected by the Commissioner. It will be remembered that, according to the scheme of the Act, returns shall be made by the several companies, and shall import, for purposes of the tax, absolute verity, unless corrected in the mode provided in the statute. If no return is made, the Commissioner is to prepare a return, upon evidence obtained in the manner prescribed by Congress; and similarly if upon an *ex parte* examination of evidence adduced before him by any person, the Commissioner is satisfied that a return as made is incorrect, he is to institute proceedings to procure additional evidence from the company, its books and its officers, and upon the evidence so acquired, he is to make a corrected return.¹

§ 120. **Nature of Commissioner's Duties.** — In supplying a return where none has been made, or in correcting an erroneous return, the Commissioner of Internal Revenue is exercising a discretionary and quasi-judicial function. But in making the assessment on the returns, he is acting in a capacity which is almost, if not quite, ministerial. To make the assessment from the data required to be given in the returns, is a mere matter of arithmetic. This is true whether the assessment is levied upon the returns as made by the companies, or upon returns supplied or corrected by the Commissioner. His quasi-judicial duties end as soon as the corrected return is com-

¹ Supra § 112.

pleted and filed. The assessment of the tax thereon is as purely a matter of mathematics as the assessment of a tax on returns made by the companies.

§ 121. **Amount of Assessment.** — The amount of the assessment in ordinary cases, is to be one per cent of the net income as ascertained from the returns.¹

In case a corporation which is subject to the tax has failed or neglected to make a return, or to verify the same by oath of the officers mentioned in the statute, so that the Commissioner of Internal Revenue is obliged to prepare a return on its behalf, then fifty per cent is to be added to the tax.² It would seem that this addition to the tax must be made where the return is delayed beyond the time limited for making it, although it be made before the Commissioner supplies the lack of it by preparing a return himself; for the Act goes on to provide in the very next sentence that in case of neglect to make a return caused by the illness or absence of an officer, or other just cause, the collector may allow further time, not exceeding thirty days, for making the return, and delivering it to the collector.³

In any case of a return "made with false or fraudulent intent," one hundred per cent is to be

¹ Act, Par. 1, lines 17-20.

² Act, Par. 5, lines 6-8 (*infra* Appx. I).

³ Act, Par. 5, lines 9-16 (*infra* Appx. I).

added to the amount of the assessment,¹ thus raising it from one to two per cent on the net income in excess of five thousand dollars.

In case of an erroneous return made under a *bona fide* mistake, there is no provision for increasing the assessment beyond the one per cent of the net income. The Act authorizes assessment to be increased only in cases of a failure to make any return in the form prescribed, and in cases of "returns made with false or fraudulent intent." It is necessary to scrutinise the phraseology of the statute rather closely; for the use of similar wording is rather confusing. Thus "false or fraudulent returns" in the middle of the Fifth Paragraph² apparently include returns which contain honest errors.³ The same is perhaps true of "false or fraudulent return" in the Eighth Paragraph.⁴ On the other hand, the words, "false or fraudulent return, or statement, with

¹ Act, Par. 5, lines 3-8 (infra Appx. I).

² Act, Par. 5, line 34 (infra, Appx. I).

³ If this were not so, there would be no provision allowing an honestly erroneous return to be corrected after June 1st. The word false is sometimes construed as equivalent to false and fraudulent, and is sometimes construed to include a statement which is merely mistaken. See 3 Words and Phrases Judicially Defined 2654-2655, tit. "False"; *McGowan v. Larsen*, 66 Fed. 910, 914 (instruction to jury that of two inconsistent defences one must be "false" held not equivalent to charging that defendant must have been guilty of a wilfully false statement, as "false" is equivalent in the charge to "erroneous"); 14 C. C. A. 178.

⁴ Act, Par. 8, line 6 (infra Appx. I).

intent to defeat or evade the assessment,"¹ appear to be synonymous with the words, "return made with false or fraudulent intent,"² and to exclude all returns which, though erroneous, are *bona fide*.

§ 122. **Time of Assessment.** — Doubtless, it is the Commissioner's duty to proceed to levy the assessment promptly on the receipt of returns from a collector. At all events, the Act provides that the assessment shall be made before June 1st.³ In the case of a return made or corrected by the Commissioner of Internal Revenue after June 1st, it is evidently expected that the assessment thereon shall be made immediately. Failure to make an assessment within the time limited is not a bar to an action to recover the amount of tax due without an assessment,⁴ if such an action is under any circumstances maintainable.⁵

§ 123. **Notice and Payment of Assessment.** — The Act provides that on or before the first day of June, in each year, the several companies shall be notified of the amount for which they are respectively liable.⁶ This statute does not expressly provide by whom this notice is to be given; but

¹ Act, Par. 8, lines 13-14 (*infra* Appx. I).

² Act, Par. 5, line 4 (*infra* Appx. I).

³ Act, Par. 5, lines 25-30 (*infra* Appx. I).

⁴ *United States v. Little Miami etc., R. R. Co.*, 1 Fed. 700, reversed as to other points, *sub nom.*, *Little Miami etc. R. Co. v. United States*, 108 U. S. 277.

⁵ As to which see *supra* § 114 and *infra* § 126.

⁶ Act, Par. 5, lines 26-30 (*infra* Appx. I).

the duty would seem to devolve upon the collector.¹ Nor is the form of notice prescribed. Oral notice would therefore be sufficient.

The assessment is payable on or before June 30th,² and to any sum or sums which may remain unpaid after that date and for ten days after notice and demand, there shall be added a penalty of five per cent of the amount of tax unpaid, and also interest at the rate of one per cent a month, or twelve per cent a year, from the date when the same became due, until it shall be paid.³ The receipt of notice is a condition to the exaction of this penalty and interest; and if the company pays within ten days after receipt of notice, it may avoid all interest and penalty. But the interest, whenever collectible, is declared to run, not from the date of the receipt of notice, but from the time the tax became "due." If this should be construed to refer to the thirtieth of June, the result would be that where notice is not received until after June 30th, prompt payment after notice would avoid all interest, but that if not paid promptly, interest from June 30th would be demandable.

In cases where, by reason of failure to make a return, or of an erroneous return, no assessment is made until after June 30th, tax shall be

¹ Rev. Stats. § 3184 (2 U. S. Comp. Stats. p. 2072). And see *infra* § 130.

² Act, Par. 5, lines 30-32 (*infra* Appx. I).

³ Act, Par. 5, lines 44-51 (*infra* Appx. I).

payable immediately after receipt of notice.¹ Unless paid within ten days after notice, the penalty of five per cent is incurred, and interest begins to run, either from the date of receipt of notice, or from the expiration of the ten days thereafter.²

Payment is to be made to the collector, who is authorized to receipt for the same.³

§ 124. **Payment under Protest.** — In case the assessment is for any reason disputed, the company should pay the assessment under protest.⁴

§ 125. **Collection — In General — Distraint, etc.** — No special machinery is provided in the Act for the collection of this tax, but the matter of collection is expressly left to be governed by the laws for the collection of other internal revenue taxes, so far as they may be applicable.⁵ The assessment of this tax is governed exclusively by the Act of 1909 by which it is imposed, but the collection of the assessment after it becomes due and payable under the Act of 1909, is governed by the same laws as other internal revenue taxes. The general laws provide that taxes unpaid after demand shall be a lien on all property and rights belonging to the delinquent tax payer from the

¹ Act, Par. 5, lines 39-44 (*infra* Appx. I).

² Act, Par. 5, lines 44-51 (*infra* Appx. I).

³ Rev. Stats., § 3183 (2 U. S. Comp. Stats. p. 2072), made applicable by the Act of 1909, Par. 8, lines 21-26.

⁴ See *infra* § 137.

⁵ Act, Par. 8, lines 21-26 (*infra* Appx. I).

time the assessment list was received by the collector.¹ The general statutes contain full provisions for the distraint and sale of personal property,² and also for the seizure and sale of real estate³ either by distraint,⁴ or by proceedings in chancery.⁵ If the delinquent has no sufficient property in the district of his residence, the assessment may be certified to the collector of any other district, who is authorized to proceed in the matter.⁶ All such matters involve no questions peculiar to the new tax, and therefore detailed discussion would be inappropriate here. The fees and charges in cases of distraint and other seizures

¹ Act, March 1, 1879, c. 125, § 3 (2 U. S. Comp. Stats. p. 2073).

² Rev. Stats., § 3187-§ 3195 (2 U. S. Comp. Stats., pp. 2073-2076); Rev. Stats., § 3205 (2 U. S. Comp. Stats., p. 2080).

³ The lien of the United States for taxes in arrears is unaffected by state recording acts: *United States v. Snyder*, 149 U. S. 210.

⁴ Rev. Stats., § 3196-§ 3205 (2 U. S. Comp. Stats., pp. 2077-2080). A sale under such a distraint would pass only the interest of the delinquent company, and would not affect the rights of a holder of a paramount title or of a lienor. See *Mansfield v. Excelsior Ref. Co.*, 135 U. S. 326; *Sheridan v. Allen*, 153 Fed. 568; 82 C. C. A. 522.

⁵ Rev. Stats., § 3207 (2 U. S. Comp. Stats., p. 2081). Cf. *Blacklock v. United States*, 208 U. S. 75 (holding that the remedy in equity is cumulative, and does not oust the right to proceed summarily by distraint).

⁶ Rev. Stats., § 3209 (2 U. S. Comp. Stats., p. 2082).

are to be fixed by the Commissioner of Internal Revenue.¹

§ 126. **By Action of Debt.** — An action of debt will of course lie to recover the amount of an assessment, if the government prefers that remedy to the more summary proceedings by way of distraint.² Perhaps an action of debt may be maintained to recover the amount which ought to have been returned and assessed, when no assessment, or too small a one, has been made.³ In such an action the defendant is entitled to a credit for amounts previously overpaid.⁴ The burden of proof is on the government to show the existence of profits, and that they were not offset by losses.⁵ It seems that although there be no statute of limitations applicable to such an action, yet "in a case where commencement of suit by the United States is delayed many years, and the delay has prejudiced a defendant by the disappearance or loss of evidence essential to his defense, courts ought to apply a rule that will protect individual rights by giving repose

¹ Rev. Stats., § 3206 (2 U. S. Comp. Stats., p. 2080).

² *Dollar Sav. Bank v. United States*, 19 Wall. 227. Such an action cannot be commenced without the approval of the Commissioner of Internal Revenue. See Rev. Stats., § 3214 (2 U. S. Comp. Stats., p. 2084).

³ See *supra* § 114.

⁴ *Missouri River etc. Co. v. United States*, 19 Fed. 66.

⁵ *Little Miami etc. R. R. Co. v. United States*, 108 U. S. 277; 2 Sup. Ct. Rep. 627.

and security to the citizen against stale claims." ¹

§ 127. **Application of other Internal Revenue Laws.** — Although this Act of Congress contains within itself a fairly complete code for the assessment of the tax, providing a special machinery for ascertaining the amount of taxable income, yet after the assessment is once made, or after any errors therein have been corrected in the mode provided in the Act, the statute makes no special provisions for any further step in respect to the tax, but, as already stated, remits the whole matter of its collection to the laws relating to the collection of other internal revenue taxes, "so far as applicable to and not inconsistent with the provisions" of the Act of 1909.² Now, in investigating which of the numerous provisions of the Revised Statutes, and the amendments thereto, relating to internal revenue, are thus extended over the so-called excise tax imposed by the Act of 1909, it is necessary to scrutinise closely the words of that Act, which deal with this matter.

Now, in the first place, it is only such of the internal revenue statutes as are "applicable to . . . the provisions of this" ³ Act which are "extended and made applicable to the tax im-

¹ *United States v. Marquette etc. R. Co.*, 17 Fed. 719, 722.

² Act, Par. 8, lines 22-24.

³ Act, Par. 8, lines 22-24 (*infra* Appx. I).

posed by this " ¹ Act of 1909. To be sure, there appears to be some absurdity in providing that laws which are already "applicable" to this new tax should be "made applicable" thereto. Such, however, is the direct language of Congress. The solecism is more apparent than real; for the intention of the legislature is reasonably clear, — namely, to guard against *excluding* by implication certain laws which by their terms are broad enough to embrace this new tax. If a law relating to collection and refund of internal revenue taxes is by its terms "applicable" to this new tax, it is "extended and made applicable" thereto, and by those words, Congress repels the possible inference that the code contained in this new Act for the collection of the tax thereby imposed was intended to be exhaustive. If, therefore, a law is "applicable" by its terms to certain specific taxes, — for instance, a tax on tobacco, whiskey, or oleomargarine, — it is not "extended" to this new tax.

In the second place, it is only such internal-revenue laws as by their terms are "relating to the *collection, remission, and refund* of internal revenue taxes," ² that are by this Act of 1909 made applicable to the new tax thereby imposed. Laws which relate to internal-revenue taxes, but not to the *collection, remission and refund* thereof, are not made applicable to this new tax, even

¹ Act, Par. 8, lines 24–25 (*infra* Appx. I).

² Act, Par. 8, lines 21–22 (*infra* Appx. I).

though their terms are sufficiently comprehensive to embrace it. On the contrary, all such laws are by implication excluded. *Expressio unius exclusio alterius*. On the same principle, a clause in the Act of Congress imposing the tax on oleomargarine, which provided that certain enumerated sections of the Revised Statutes relative to internal-revenue taxes should be applied to the oleomargarine tax, was held to exclude by implication another section, although the terms of the latter section were in themselves sufficiently broad to have covered the oleomargarine tax, if nothing had been said in the oleomargarine law to exclude by inference its application.¹

Bearing these principles in mind, let us briefly survey the internal-revenue statutes of the United States for the purpose of ascertaining which of them relate to the present tax.

§ 128. **Powers of Secretary of Treasury.** — The Secretary of the Treasury is authorized to “superintend the collection of the revenue,” and to “prescribe forms of entries, oaths, bonds, and other papers, and rules and regulations not inconsistent with law, to be used under and in the execution of the internal-revenue laws.”² To

¹ *Schafer v. Craft*, 144 Fed. 907; *In re Kinney*, 102 Fed. 468; *In re Kearns*, 64 Fed. 481; *Tucker v. Gier*, 160 Fed. 611; 87 C. C. A. 513.

² Rev. Stats., § 251 (1 U. S. Comp. Stats., p. 138). A still more general provision authorises any head of a department “to prescribe regulations, not inconsistent with law, for the government of his Department, the conduct of its officers

some extent this authority doubtless extends to the new tax. Neither "entries" nor "bonds" are provided for in connection with the present tax, and to that extent this section is inapplicable. The only "rules and regulations" which the Secretary can make with respect to the new tax relate to its "collection, remission and refund"; he has no power to make regulations respecting its assessment. The only rules and regulations upon that subject are prescribed by Congress in the Act. The section of the Revised Statutes above cited goes on to provide that the Secretary of the Treasury "shall give such directions to collectors and prescribe such rules and forms to be observed by them as may be necessary for the proper execution of the law." This provision would seem to be applicable to the new tax. But it must be borne in mind, and will be more fully explained in a moment, that the duties of collectors in connection with this new tax are not numerous or important until an assessment is placed in their hands for collection by distraint. They are not inquisitorial officers, as they are in

and clerks, the distribution and performance of its business, and the custody, use and preservation of the records, papers and property appertaining to it." Rev. Stats., § 161 (1 U. S. Comp. Stats., p. 80), held in *Boske v. Commingore*, 177 U. S. 459, to authorise the Secretary of the Treasury to forbid collectors to produce papers in their custody in state courts under a *subpœna duces tecum*. As to the extent of the power to prescribe treasury regulations, see *supra* § 90, § 101.

connection with some other internal-revenue taxes, such as the tax on distillers.

§ 129. **Powers of Commissioner of Internal Revenue.** — “ The Commissioner of Internal Revenue, under the direction of the Secretary of the Treasury, shall have general superintendence of the assessment and collection of all duties and taxes now or hereafter imposed by any law providing internal revenue.” ¹ This provision would seem clearly to be applicable to the new tax so far as it relates to the “ collection ” of internal-revenue taxes; but the distinction, which runs all through the internal-revenue laws,² between the “ assessment ” ³ and the “ collection ” thereof, must always be remembered. The Act of 1909 adopts only so much of this section as relates to the “ collection ” as distinguished from the “ assessment ” of the taxes.⁴

This Section, § 321, of the Revised Statutes goes on to provide that the Commissioner of Internal Revenue, under the direction of the Secretary of the Treasury, “ shall prepare and distribute all the instructions, regulations, directions, forms, blanks, stamps, and other matters, pertaining to the assessment and collection of internal rev-

¹ Rev. Stats., § 321.

² For example, note the heading of Revised Statutes, Title 35, Chapter 2, “ Of Assessments and Collections.”

³ As to the meaning of the word “ assessment,” see *Jackson Lumber Co. v. McCrimmon*, 164 Fed. 759, 763-764.

⁴ Cf. *supra*, § 118, § 127, and *infra* § 130.

enue." This provision also is applicable to the "collection" of the new tax; but the same distinction between assessment and collection is again to be noted. The only power of the Commissioner of Internal Revenue to prescribe forms in connection with the assessment of this tax is that expressly vested in him by the Act of 1909 to prescribe the form of return.¹

Section 3182,² as to the making of assessments by the Commissioner of Internal Revenue and as to the correction of imperfect lists, is inconsistent with the Act of 1909, which contains full provisions upon that subject.³ Moreover, it relates to the "assessment," rather than the "collection" of taxes.

§ 130. **Powers and Duty of Collectors.** — As already stated, the duties of collectors,⁴ in connection with the present tax, are few and simple, until an assessment has been made and is placed in their hands for collection. They are to receive the returns made by the corporations, and forthwith transmit them to the Commissioner of Internal Revenue;⁵ — that is all. By general provision of law, each collector within his district, is to "see that all laws and regulations

¹ See *supra* § 90.

² Rev. Stats., § 3182 (2 U. S. Comp. Stats., p. 2071).

³ See *supra* § 106-§ 113.

⁴ As to delegation of duties to deputy collectors, see Act, March 1st, 1879, c. 125, § 2 (2 U. S. Comp. Stats., p. 2043).

⁵ *Supra* § 89, § 102.

relating to the collection of internal taxes are faithfully executed and complied with, and shall aid in the prevention, detection and punishment of any frauds in relation thereto.”¹ This provision is undoubtedly to some extent applicable to the present tax; but as will appear below, its application is limited by the lack of ability of collectors under the law to acquire information as to frauds upon this new law. Similar remarks are applicable to another general provision of law directing each collector to cause his deputies “to proceed through every part of his district and inquire after and concerning all persons therein who are liable to pay any internal revenue tax.”²

Collectors are in some circumstances authorized to administer oaths, and to take evidence touching any part of the administration of the internal-revenue laws with which they are charged or when such oaths and evidence are authorized by law or regulation to be taken.³ This section may authorize collectors to administer the oath

¹ Rev. Stats., § 3163, as amended by Act, March 1st, 1879, c. 125, § 2 (2 U. S. Comp. Stats., p. 3163). See also Rev. Stats., § 3169 (2 U. S. Comp. Stats., p. 2059) as to, inter alia, duty to report violations of law to superior officer; Rev. Stats., § 3164 (2 U. S. Comp. Stats., p. 2057), as to duty to report violations of law to district attorney.

² Act, Aug. 27, 1894, c. 349 § 34 (2 U. S. Comp. Stats., p. 2065). The word “person” in this statute includes corporations. See Rev. Stats., § 1 (1 U. S. Comp. Stats., p. 3).

³ Rev. Stats., § 3165, as amended in 1879 (2 U. S. Comp. Stats., p. 2057).

to officers of corporations swearing to their returns; but would seem to have no other application to proceedings under this Act of 1909.

The general statute prohibiting collectors and other officers or employees from divulging in any manner not authorized by law, information acquired by them in the course of their official duties, would seem to be largely, if not altogether, superseded, as to this tax, by the special provisions on that subject, contained in the Act of 1909.¹

Section 3173 of the Revised Statutes, which was amended by Act of 1894,² relates to returns to the collectors by persons liable to tax; but this section is manifestly inconsistent with the provisions of the Act of 1909, and is for other reasons inapplicable to the tax thereby imposed.³ This is a quite important point, because this section authorizes the collector to summon the person liable to the tax, and to compel him to produce his books for inspection. The two succeeding sections of the Revised Statutes,⁴ relate respect-

¹ As to which, see *supra* § 116, § 117.

² Act 1894, c. 349, § 34 (2 U. S. Comp. Stats., pp. 2065-2067). This section was among those held void in *Pollock v. Farmers' L. & T. Co.*, 158 U. S. 601, 637; 15 Sup. Ct. Rep. 912; 157 U. S. 429; 15 Sup. Ct. Rep. 673.

³ It should be noted that the section prior to the void amendment of 1894 related merely to taxes on "articles or objects charged with a special duty or tax," and on "goods, wares, and merchandise," or tangible property, and not to taxes on business or income, such as this new tax of 1909.

⁴ Rev. Stats. § 3174, § 3175 (2 U. S. Comp. Stats., pp. 2067, 2068).

ively to the form and service of such a summons, and to the punishment for disobedience thereof. As the provision for the summons itself has no application to this corporation tax, those two subsidiary sections are likewise irrelevant.

The following section of the Revised Statutes,¹ attempted to be amended in 1894,² authorizes collectors to make returns where no return has been made as required by law, or where a fraudulent return has been made. This section is inapplicable (1) because it relates to the "assessment" rather than to the "collection" of the tax,³ (2) because the Act of 1909 contains different and inconsistent provisions for supplying a return where none has been made, and for correcting an erroneous return,⁴ and (3) because this section, prior to the void amendment of 1894, merely authorized collectors to make returns of "*objects* liable to tax," whereas the tax of 1909 is not levied upon objects, but upon income, franchise, or business.

The next section of the Revised Statutes authorizes collectors to enter in the day time any building or place where "articles or objects subject to tax" are kept, for the purpose of exam-

¹ Rev. Stats., § 3176 (2 U. S. Comp. Stats., p. 2069).

² Act, Aug. 27, 1894, c. 349, § 34, held void in *Pollock v. Farmers' L. & T. Co.*, 158 U. S. 601, 637; 15 Sup. Ct. Rep. 912; 157 U. S. 429; 15 Sup. Ct. Rep. 673.

³ See *supra* § 118, § 127, § 129.

⁴ See *supra* § 104, § 106-§ 113.

ining them;¹ but as there are no "articles or objects liable to tax" under the Act of 1909, this provision has no application to the tax imposed thereby.²

Section 3179,³ imposing penalties for false return, or for refusal to produce books when ordered, is inconsistent with the provisions of the Act of 1909, and is for other reasons inapplicable.

Section 3184⁴ relates to notice of assessment; and is so far applicable to this tax as to impose upon the several collectors the duty of serving notice of assessment and demand for payment under the Act of 1909.

§ 131. **Miscellaneous Other Provisions of Internal Revenue Laws.** — The other provisions of the internal-revenue laws, except those which are specially considered elsewhere in this treatise, are either manifestly inapplicable to this tax, or else they relate to collection, by distraint or otherwise, after an assessment has been made, in which case they are certainly applicable.

¹ Rev. Stats., § 3177 (2 U. S. Comp. Stats., pp. 2069-2070). A query has been thrown out whether this section applies to a place where paid unstamped bank cheques are kept: *United States v. Mann*, 95 U. S. 580, 584.

² Rev. Stats., § 3180 (2 U. S. Comp. Stats., p. 2071), as to inspection of taxable objects owned by non-residents, is for similar reasons inapplicable.

³ Rev. Stats., § 3179 (2 U. S. Comp. Stats., p. 2070).

⁴ Rev. Stats., § 3184 (2 U. S. Comp. Stats., p. 2072).

CHAPTER VII

REMEDIES

- § 132 No direct appeal to court provided.
- § 133 Injunction.
- § 134 Mandamus, etc.
- § 135 Passive resistance.
- § 136 Action of trespass, trover, etc., for goods distrained.
- § 137 Action to recover back taxes paid under protest.
- § 138 Remedy by application to Commissioner of Internal Revenue.

§ 132. — No Direct Appeal to Court Provided. —
In the assessment of a tax, particularly a tax which involves so many difficult questions of accounting, and of the law of capital and income, errors are very likely to be committed by the administrative officials charged with the assessment and collection of the tax. Nevertheless, this law gives no appeal to court for a direct review of the intricate questions of law and fact which will constantly arise. The absence of some provision for a review by an impartial tribunal is certainly a blemish in the law. The Commissioner of Internal Revenue, who is charged by this Act with quasi-judicial functions, is an officer or agent of the government, and as such his duty

is to be zealous in augmenting the revenue of the government. He cannot be at once a zealous agent of the United States and an impartial judge between the government and the taxpayer.

It is true that the fact that the returns made by the several corporations are to be taken as *prima facie* correct and that all assessments are to be made "thereon" unless affirmative evidence of their falsity is produced before the Commissioner¹ is some protection to the companies which are subject to the tax; but whenever the Commissioner exercises quasi-judicial functions in respect to intricate questions of law, as he does whenever it becomes his duty to prepare a corrected return, there ought to be some simple, cheap and speedy remedy by a judicial review of his rulings.

This statute remits the whole matter to the general provisions of the statutes of the United States for the collection, remission and refund of internal-revenue taxes.² To the general remedies against illegal taxes, as existing by the common law of theseveral states and as regulated or enlarged by the general internal-revenue statutes of the United States, we must therefore look.

§ 133. **Injunction.** — Although courts of equity, in order to avoid irreparable injury and multiplicity of suits, would sometimes apart from statute

¹ See *supra* § 103, § 106, § 119, § 120.

² Act, Par. 8, lines 21-26 (*infra* Appx. I).

enjoin the collection of an illegal tax, yet as to federal taxes this remedy is specifically prohibited by Act of Congress, which provides that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court."¹ This statute, however, does not apply to a suit by a shareholder in a corporation to enjoin the company and its directors from voluntarily paying an unconstitutional tax. Such a suit can therefore be maintained on the ground that it is *ultra vires* to apply money belonging to the company in payment of an unconstitutional tax.² It does not appear, however, that this principle has ever been extended to an injunction against paying a tax which is neither unconstitutional or illegal as a whole but is merely erroneous as to amount. This remedy by a shareholder's bill may, therefore, be invoked in order to test the constitutionality of the present law; but it is more doubtful whether it would afford relief, if the Act is not wholly unconstitutional, in order to restrain the directors from paying a tax which is assessed on erroneous principles — for example, where some items are wrongly in-

¹ Rev. Stats., § 3224 (2 U. S. Comp. Stats., p. 2088) enforced in *Snyder v. Marks*, 109 U. S. 189; 3 Sup. Ct. Rep. 157; *Miles v. Johnson*, 59 Fed. 38; *Delaware R. Co. v. Prettyman*, 7 Fed. Cas. 408.

² *Pollock v. Farmers' L. & T. Co.*, 157 U. S. 429, 453-454; 15 Sup. Ct. Rep. 673; 158 U. S. 601; 15 Sup. Ct. Rep. 912. As to such suits, see also 2 Machen, *Mod. Law of Corps.*, § 1153, and *Memphis City v. Dean*, 8 Wall. 64, 73.

cluded in the gross revenue or where the Commissioner of Internal Revenue has not given the company the benefit of the deductions to which it is entitled. If it should be thought *ultra vires* for directors of a corporation to divulge any of the secrets of the company except under compulsion of law, a shareholder might enjoin them from setting out in their return any particulars in regard to its business not required by the Act to be stated therein; but except under very peculiar charters the directors have ample power at their discretion to disclose any facts about the company to the public or any person they please, even a tax-collector, and therefore they could not be enjoined from doing so.

§ 134. **Mandamus, etc.** — No state court has power to issue a writ of mandamus to a federal officer in any case.¹ Moreover, the United States Courts have no power to issue that writ except as incidental to their appellate jurisdiction.² But the courts of the District of Columbia, where the office of the Commissioner of Internal Revenue is situated, may in a proper case issue a mandamus against him as against any head of a bureau,³

¹ *McClung v. Silliman*, 6 Wheat. 598.

² *McIntire v. Wood*, 7 Cranch 504; *Marbury v. Madison*, 1 Cranch 137; *McClung v. Silliman*, 2 Wheat. 369; *County of Greene v. Daniel*, 102 U. S. 187, 195; *Davenport v. County of Dodge*, 105 U. S. 237.

³ *United States v. Black*, 128 U. S. 40; 9 Sup. Ct. Rep. 12; *Butterworth v. Hoe*, 112 U. S. 50; 5 Sup. Ct. Rep. 25.

or even against a cabinet officer.¹ If, therefore, the Commissioner should omit to perform any ministerial duties imposed upon him by this Act, he might be coerced by mandamus.² For instance, if he should decline to make the assessment on the return as filed, without any evidence produced before him of its incorrectness, — for example, merely because the corporation had refused to state in the return particulars demanded by the Commissioner in addition to those required by Congress to be set out therein — it is submitted that mandamus would lie to compel him to perform his ministerial duty of calculating the amount of the assessment on the data furnished in the return. On the other hand, the United States courts will not control a federal executive officer in the exercise of quasi-judicial functions,³ even though the questions before him be questions of pure law.⁴

¹ *United States v. Schurz*, 102 U. S. 378; *Marbury v. Madison*, 1 Cranch 137; *Kendall v. United States*, 12 Pet. 524 (to be compared with *Kendall v. Stokes*, 3 How. 87, an unsuccessful action for damages against the cabinet officer).

² As to the remedy by certiorari, cf. *Alexandria Canal Co. v. The District*, 5 Mackey (D. C.) 376.

³ *Carrick v. Lamar*, 116 U. S. 423; 6 Sup. Ct. Rep. 424; *United States v. Windom*, 137 U. S. 636; 11 Sup. Ct. Rep. 197; *United States v. Blaine*, 139 U. S. 306; 11 Sup. Ct. Rep. 607.

⁴ *Gaines v. Thompson*, 7 Wall. 347; *United States v. Black*, 128 U. S. 40; 9 Sup. Ct. Rep. 12; *Commissioner of Patents v. Whiteley*, 4 Wall. 522; *Decatur v. Paulding*, 14 Pet. 497.

§ 135. **Passive Resistance.** — Another remedy which may sometimes be better is by what may be called passive resistance. That is to say, the company, having done what it conceives to be its full duty in supplying a return, may quietly and passively refuse to do anything further. It will then become necessary for the Commissioner of Internal Revenue to invoke the aid of the United States Courts in order to compel the officers to testify and to produce the company's books. In these legal proceedings, the jurisdiction of the Commissioner to proceed to examination of the officers and inspection of the books can be attacked and tested.¹

§ 136. **Action of Trespass, Trover, etc., for Goods Distrained.** — If a corporation, conceiving that an assessment is illegal, refuses to pay the same, its goods may be seized and sold under distraint proceedings. If the assessment is void and if the facts to show its invalidity appear on its face, the officer who levies the distraint may be sued in trover, trespass or other appropriate action. Such an action may be maintained without first appealing to the Commissioner of Internal Revenue.² If, however, the assessment is fair on its face and made by an officer having jurisdiction, the collector will be protected in acting thereunder though it may be erroneous, at any rate unless

¹ See *supra* § 108.

² *Erskine v. Hohnbach*, 14 Wall. 613.

he is informed of extraneous facts which render the assessment invalid.¹

§ 137. **Action to Recover Back Taxes Paid under Protest.** — The usual remedy to test the legality of assessments of federal taxes is by first paying the taxes under protest and then bringing an action of assumpsit against the collector to recover back the amount so paid;² but money paid without protest cannot be recovered back,³ nor will protest suffice unless under threat of proceedings by the government to collect the tax.⁴ The declaration or complaint should set out the transactions upon which the assessment was made.⁵

¹ *Erskine v. Hohnbach*, 14 Wall. 613; *Stutsman County v. Wallace*, 142 U. S. 293, 310; 12 Sup. Ct. Rep. 297; *Delaware R. Co. v. Prettyman*, 7 Fed. Cas 408.

² *Elliott v. Swartwout*, 10 Pet. 137; *Erskine v. Van Arsdale*, 15 Wall. 75; *Assessor v. Osbornes*, 9 Wall. 567, 574; *Commissioners v. Buckner*, 48 Fed. 533; *Chicago Distilling Co. v. Stone*, 140 U. S. 647; 11 Sup. Ct. Rep. 862; *Armour v. Roberts*, 151 Fed. 846 (recovery allowable though collector would not be liable as a trespasser). As to execution on a judgment for the plaintiff in any such action, see Rev. Stats. § 999 (1 U. S. Comp. Stats. 708), construed in *Agnew v. Haymes*, 141 Fed. 631.

³ *Elliott v. Swartwout*, 10 Pet. 137. The protest need not be in writing: *Wright v. Blakeslee*, 101 U. S. 174, 179 (headnote inadequate). Anything sufficient to apprise the collector that the taxpayer contends that the taxes are illegal and intends to sue for their recovery is enough: *Herold v. Kahn*, 159 Fed. 608; 86 C. C. A. 598.

⁴ *Cheeseborough v. United States*, 192 U. S. 253; 24 Sup. Ct. Rep. 262.

⁵ *Haight & Freese Co. v. McCoach*, 135 Fed. 894.

Interest is recoverable from the date of the payment.¹ Under the Tucker Act, such claims may be made the subject of an action against the United States in the Court of Claims or in a United States Circuit or District Court.²

This remedy against the collector as well as against the United States may constitutionally be taken away by Congress;³ and under the Internal Revenue Laws it is provided that an appeal to the Commissioner of Internal Revenue to repay the amount of the tax shall be a condition precedent to the institution of any such action.⁴ There has been some doubt whether this statute applies where the original assessment which is alleged to be illegal was made by the Commissioner himself and where there has already

¹ *Erskine v. Van Arsdale*, 15 Wall. 75; *Kinney v. Conant*, 166 Fed. 720; *McClain v. Pennsylvania Co.*, 108 Fed. 618; 47 C. C. A. 529; *Herold v. Kahn*, 163 Fed. 947. Cf. *Commissioners v. Buckner*, 48 Fed. 533; *Burrough v. Abel*, 105 Fed. 366 (interest disallowed on account of laches).

² *Christie-Street Commission Co. v. United States*, 136 Fed. 326 (distinguishing *United States v. Savings Bank*, 104 U. S. 728, 734); *Dooley v. United States*, 182 U. S. 222; 21 Sup. Ct. Rep. 762.

³ *Cary v. Curtis*, 3 How. 236.

⁴ Rev. Stats., § 3226 (2 U. S. Comp. Stats. p. 2088), enforced in *Hubbard v. Collector*, 12 Wall. 1. Cf. *De Barry v. Dunne*, 162 Fed. 961 (holding that defense based on non-performance of the statutory condition is not waived by general appearance and plea to the merits). As to what is necessary evidence in order to prove compliance with this statute, see *Hubbard v. Kelley*, 8 W. Va. 46.

been a hearing of the question before him.¹ But the safer plan is even in that case to address to him an appeal for refunding of the tax before bringing suit.² In order to comply with this statute there must first be an application to the collector and an adverse decision by him and from him an appeal to the Commissioner; and therefore an application to the Commissioner in the first instance is not enough, though rejected by him, to authorise the institution of an action against the collector.³ The mere noting of protest on the return against the form on which it is required to be made is not enough.⁴ The statute does not prevent a citizen from defending a suit for collection of an illegal tax without first appealing to the Commissioner,⁵ nor does it apply to an action of trespass against a collector for seizing plaintiff's property under an illegal distraint.⁶

There is a period of limitations of two years prescribed by Congress for the institution of such

¹ Cf. *De Barry v. Dunne*, 162 Fed. 961; *Tucker v. Grier*, 160 Fed. 611; 87 C. C. A. 513.

² For the statute apparently contemplates an appeal made to the Commissioner after payment of the tax: *Kings County Sav. Institution v. Blair*, 116 U. S. 200, 205; 6 Sup. Ct. Rep. 353. But see *Schwarzchild v. Rucker*, 143 Fed. 656.

³ *Cheeseborough v. United States*, 192 U. S. 253, 262-263.

⁴ *Kings County Sav. Institution v. Blair*, 116 U. S. 200, 205 (headnote inadequate); 6 Sup. Ct. Rep. 353.

⁵ *Clinkenbeard v. United States*, 21 Wall. 65.

⁶ *Supra* § 136.

suits.¹ Moreover, such a suit cannot be maintained unless the appeal to the Commissioner was taken within the time limited for taking such appeals.² The period of limitations prescribed by Rev. Stats. § 3227 applies to suits brought against the United States under the Tucker Act as well as to suits against the collector.³

This remedy is very efficient where the assessment is wholly void. Even if it is not wholly void, but is merely made upon an erroneous principle in conflict with some statutory direction so as to be excessive, the party aggrieved may have the aid of the courts to recover the amount of the excess; ⁴ but he cannot have a review of any question of valuation committed to the judgment of the assessing tribunal.⁵ If, however,

¹ Rev. Stats., § 3227 (2 U. S. Comp. Stats. p. 2089). Cf. *Wright v. Blakeslee* 101 U. S. 174 (holding that the period does not begin to run until rejection of the claim by the Commissioner); *Commissioners v. Buckner*, 48 Fed. 533 (bar removed by Act of Congress); *Hicks v. James*, 48 Fed. 542 (claim held not barred), affirmed, *James v. Hicks*, 110 U. S. 272; 4 Sup. Ct. Rep. 6; *Cheatham v. United States*, 92 U. S. 85; *Braun v. Sauerwein*, 10 Wall. 218; *Schwarzchild v. Rucker*, 143 Fed. 656 (if appeal to Commissioner not decided within six months action barred at end of two years after expiration of the six months).

² *Kings County Sav. Institution v. Blair*, 116 U. S. 200; 6 Sup. Ct. Rep. 353.

³ *Farrell v. United States*, 167 Fed. 639; *Christie Street Commission Co. v. United States*, 136 Fed. 326.

⁴ *Herold v. Shanley*, 146 Fed. 20, and many other cases.

⁵ *Stanley v. Supervisors of Albany*, 121 U. S. 535, 550-

the Commissioner of Internal Revenue should in undertaking to correct a return receive illegal evidence — for instance, if he should consider evidence of other witnesses than officers and employees of the company and its books and papers — his corrected return and the assessment thereon would be illegal; and the action to recover back the taxes paid under protest might be maintained.

§ 138. **Remedy by Application to Commissioner of Internal Revenue.** — The federal statutes expressly authorise the Commissioner of Internal Revenue to refund taxes erroneously or illegally assessed or collected, or taxes unjustly assessed or excessive in amount, or in any manner wrongfully collected.¹ Such application to the Commissioner can only be made within two years.² The lodging of an appeal with the collector for transmission in due course to the Commissioner is in effect a presentation of the appeal to the Commissioner within the meaning of a statute limiting the time within which appeals may be presented to the Commissioner.³ In exercising

551; 7 Sup. Ct. Rep. 1234. Cf. *United States v. Rindskopf*, 105 U. S. 418, 422.

¹ Rev. Stats., § 3220 (2 U. S. Comp. Stats., p. 2086).

² Rev. Stats., § 2228 (2 U. S. Comp. Stats., p. 2088).

³ *United States v. Savings Bank*, 104 U. S. 728 (with which compare *Cotton Press Co. v. Collector*, 1 Woods, 296). As to the limitation of time for appealing to the Commissioner, see *Kings County Sav. Institution v. Blair*, 116 U. S. 200; 6 Sup. Ct. Rep. 353.

this jurisdiction, the Commissioner is not bound by strict or technical rules, and may direct remission of a tax paid without protest.¹ If he decides in favor of an applicant and payment is nevertheless refused by the disbursing officers of the government, a suit will lie against the United States in the Court of Claims or in a United States Circuit or District Court to recover the amount of the award.²

¹ *Cheeseborough v. United States*, 192 U. S. 253; 24 Sup. Ct. Rep. 262.

² *United States v. Savings Bank*, 104 U. S. 728; *Edison El. Ill. Co. v. United States*, 38 Ct. of Cl. 208.

CHAPTER VIII

CONSTITUTIONALITY

- § 139 In general.
- § 140 Statement of objections to constitutionality of the law.
- § 141 *Pollock v. Farmers' Loan and Trust Co.*
- §§ 142-144 Is the present tax a "direct tax"?
- § 142 Tax on income from a particular employment not a direct tax.
- § 143 Is the present tax within that principle?
- § 144 A suggested distinction from the income-tax cases.
- § 145 Is the tax invalid as a federal tax on a state franchise?
- § 146 The objection of inequality.
- § 147 Constitutionality as applied to income from state and municipal securities.
- § 148 Retroactive features of the law.
- § 149 Consequences of partial unconstitutionality.

§ 139. **In General.** — The question of the constitutionality of the tax has been reserved for consideration here, because, although the constitutionality of the law is the first question that a lawyer who is called upon to consider the statute must decide, yet the question of constitutionality, in all its multiform phases, cannot be thoroughly understood until the meaning of the Act is first fully comprehended.

As stated above, it is a matter of common knowl-

edge that this tax was proposed in the Senate as an amendment to the Tariff Bill of 1909, as a substitute for a pending amendment which would have attempted to levy a general income tax.¹ It was believed by the advocates of this tax that the constitutional objections to a general income tax were obviated by this Act. There is, however, ground for serious doubt whether this belief was wholly justified.

§ 140. **Statement of Objections to Constitutionality of the Law.** — There are at least four possible objections that may be urged against the constitutionality of the Act, or important parts of the Act: —

(1) That it attempts to levy a “direct tax” without apportionment between the states in proportion to their population, as required by the Constitution.

(2) That it amounts to a tax on franchises granted by the several states, and is therefore within the principle that the Federal Government has no power to tax the governmental functions of the states.

(3) That the tax is unequal, and not “uniform.”

(4) That in so far as the Act attempts to tax income derived from state and municipal securities, it is unconstitutional as a tax upon the agencies of the state governments.

§ 141. **Pollock v. Farmers' Loan & Trust Co.** —

¹ Supra § 1.

All of these objections are connected with the famous case in which the Income Tax Law of 1894 was held unconstitutional.¹ The statute involved in that case purported to lay a general tax on all incomes both of individuals and of corporations. Four thousand dollars of the income of every individual was exempt; but no such exemption was allowed to corporations. The case was twice argued in the Supreme Court. At the first hearing the Court held, (1) unanimously, that in so far as the Act attempted to tax income derived from state and municipal securities, it was a tax on agencies of the state governments, and as such was unconstitutional, and (2) by six judges to two, that a tax on income derived from land is equivalent to a tax on the land itself, and as such is a "direct tax" within the meaning of the Constitution, and is therefore void unless apportioned among the states. Upon the question whether a tax on income derived from personal property is a direct tax, the judges were equally divided in opinion; and were similarly divided upon the question whether the tax levied by the Act of 1894 was unconstitutional because of lack of equality.

Upon rehearing, the Court unanimously adhered to the ruling that the Act of Congress, in so far as it attempted to tax income from state

¹ *Pollock v. Farmers' L. & T. Co.*, 157 U. S. 429; 15 Sup. Ct. Rep. 673; and, on rehearing, 158 U. S. 601; 15 Sup. Ct. Rep. 912.

and municipal securities, was void. The Court, by a bare majority of five judges to four, adhered to the previous ruling that a tax on the income of land is a "direct tax," and further held that a tax on the income of invested personal property of all descriptions is also a "direct tax," and therefore unconstitutional unless apportioned among the states according to their population. A majority of the Court was also of opinion that as the income-tax provisions of the Act of 1894 embraced one indivisible, harmonious system; and as they were unconstitutional in so far as they taxed income from real estate and from invested personal property, it would defeat the presumable intention of Congress to uphold them in so far as they taxed income derived from a business or employment. For this reason, all the income-tax provisions of the Act of 1894 were held void. It thus became unnecessary to express any opinion upon the question, whether the Act was void for inequality. Notwithstanding the criticism to which this decision has been subjected, there is no reason to suppose that the Supreme Court would overrule it, although it might be rather closely limited.

§ 142. Is the present Tax a "Direct Tax"? — Tax on Income from a Particular Employment not a Direct Tax. — The law may be regarded as settled that a tax upon the income derived from a particular business or employment is an excise tax, and not a direct tax, so that it may be

levied by Congress without apportionment among the states in proportion to population¹ No case has ever carried this doctrine to the extent of upholding a general income tax levied upon the income of all classes of business, but not extending to income from invested personal property and real estate, but there seems no reason to doubt that in a case presenting the question, the court would carry the doctrine to that extent. Such taxes are not taxes on property, but on the carrying on of business.

§ 143. **Is the Present Tax within That Principle?**—It is under the principle just stated that it is sought to maintain the validity of the present tax. Attention has already been directed to the difficulty in holding this tax to be what it is designated by Congress, — namely, “a special excise tax with respect to the carrying on or doing business,” — rather than what in substance it amounts to: namely, a tax on income from all sources.² Unlike the tax upheld in *Spreckels Sugar Refining Co. v. McClain*,³ this tax is not confined to receipts from business, but expressly includes income derived from all other

¹ *Spreckels Sugar Refining Co. v. McClain*, 192 U. S. 397; 24 Sup. Ct. Rep. 376; *Pacific Ins. Co. v. Soule*, 7 Wall. 433. Cf. *Maine v. Grand Trunk Ry. Co.*, 142 U. S. 217, 227–228; 12 Sup. Ct. Rep. 121, 163; *Western Union Tel. Co. v. Massachusetts*, 125 U. S. 530; 8 Sup. Ct. Rep. 961.

² *Supra* § 4–§ 10.

³ 192 U. S. 397.

sources, including invested capital.¹ It would seem, therefore, difficult, to say the least, to sustain this law in its entirety without impinging upon the principle of *Pollock v. Farmers' Loan & Trust Co.*,² that a tax upon income of property is a tax on the property itself. It would not, however, follow that the tax must, for this reason, be declared wholly unconstitutional;³ for the objections just stated would affect the validity of the tax only in so far as it relates to income from investments.

§ 144. **A Suggested Distinction from the Income-Tax Cases.** — It may be said that *Pollock v. Farmers' Loan & Trust Co.* declared a tax on the income of all persons over a certain amount to be a direct tax, but that it does not follow that a tax on the income of such persons only as are engaged in certain businesses or employments, would be a direct tax.⁴ If this argument is sound, a general tax on the income of all persons would be a direct tax; but a tax on the income of all lawyers or doctors, although not confined to

¹ *Supra* § 5, § 9.

² 157 U. S. 429; 158 U. S. 601.

³ *Infra* § 149.

⁴ In support of this argument, it should be mentioned that while a general tax on personal property of all kinds was held in *Pollock v. Farmers' L. & T. Co.*, 158 U. S. 601; 15 Sup. Ct. Rep. 912; 157 U. S. 429; 15 Sup. Ct. Rep. 673; to be a direct tax, and not an excise, yet a tax on certain kinds of personal property is deemed an excise. See *Patton v. Brady*, 184 U. S. 608; 22 Sup. Ct. Rep. 493.

income derived from their practice of those professions, but including income derived from rents of real estate, and invested personal property, would be an excise tax on engaging in the profession of the law or medicine. When we remember the small proportion of the income of some lawyers which is derived from the practice of their profession, we can appreciate the length to which the supporters of this argument must be prepared to go. But suffice it to say that if this argument is sound, all objection to the present tax, on the score of its being a direct tax levied without apportionment, is removed.

§ 145. Is the Tax Invalid as a Federal Tax on a State Franchise? — It has been stated above that this tax is not levied upon any corporate franchise or franchises; for the simple reason that unincorporated joint stock companies are taxed equally with corporations.¹ For this reason the objection that the tax is a federal tax on franchises granted by the states, and as such is unconstitutional, falls to the ground.

But apart from this simple answer to the objection, it may be doubted whether a federal tax on the right or franchise to exist as a corporation under state laws would be unconstitutional,² unless the corporation were formed as a governmental agency of the state. It may be true that a state cannot tax a franchise of any kind granted

¹ Supra § 11.

² *Veazie Bank v. Fenno*, 8 Wall. 533, 547.

by the United States;¹ but this is not merely because the franchise is a governmental agency of the United States within the doctrine of *McCulloch v. Maryland*,² but because of the supremacy of federal laws. Thus a state is without power to tax a patent right,³ not because patents are agencies of the federal government, but because a valid federal law gives the patentee the right to exclusive use of his invention, and a state law forbidding him to enjoy that right, except upon the condition of paying a tax to the state, is in conflict with the federal law, and must therefore yield to the law of superior force.

For this reason, decisions holding that a state cannot tax a corporate franchise granted by the United States, are not authority for the proposition that the United States could not tax similar franchises granted by a state. Moreover, Congress has no power to create corporations within the states, except as a means of carrying out its governmental powers, so that every corporate franchise granted by the United States is necessarily a governmental agency of the United States. A state, on the other hand, has power to allow incorporation for any lawful purpose, — even a merely private purpose, — and to abrogate the common law rule

¹ *Central Pac. R. R. Co. v. California*, 162 U. S. 91; 16 Sup. Ct. Rep. 766; *California v. Central Pac. R. R. Co.*, 127 U. S. 1, 41; 8 Sup. Ct. Rep. 1073.

² 4 Wheat. 316.

³ *Re Sheffield*, 64 Fed. 833.

which prohibited the formation of corporations without a license from the Crown, so that state corporations are not necessarily governmental agencies. If a state corporation were created as a means of exercising some governmental power, — for example, as a means of regulating the liquor traffic, — a very different question would be presented.¹

§ 146. **The Objection of Inequality.** — If the present tax is an excise, rather than a direct tax, it is within the constitutional requirement, that “all duties, imposts, and excises shall be uniform throughout the United States”; but it is now well settled that this provision, in accordance with the natural meaning of the words, has exclusive reference to geographical uniformity.² The power to levy excise taxes is, however, restricted by the provision of the Fifth Amendment, that no person shall be deprived of life, liberty or property without due process of law. Moreover, a certain amount of equality may be inherent in the power of taxation as distinguished from arbitrary exactions and confiscation.

Now the present tax will undoubtedly cause a certain amount of inequality. In the first place,

¹ Apparently, however, the power of federal taxation would extend even to such cases: *South Carolina v. United States*, 199 U. S. 437; 26 Sup. Ct. Rep. 110.

² *Patton v. Brady*, 184 U. S. 608, 622–623; 22 Sup. Ct. Rep. 493; *Knowlton v. Moore*, 178 U. S. 41, 106; 20 Sup. Ct. Rep. 747; *Head-Money Cases*, 112 U. S. 580, 594; 5 Sup. Ct. Rep. 247.

it is levied only on companies having a share capital, and insurance companies. It discriminates against such companies, and the economic wisdom is, therefore, in the writer's judgment, more than questionable; but such a consideration is for the legislature, rather than the courts. The judiciary can hardly say that the discrimination is so gross and arbitrary as to convert the exaction into mere confiscation, and to destroy its character as a tax.¹

In the Income Tax Cases, great stress was laid by the appellants on the fact that the statute exempted incomes of less than four thousand dollars, and was thus unequal in its operation, and this argument seems to have commanded the assent of four judges. But no reliance can be placed upon the similar exemption in the present Act as affecting its validity; for the Supreme Court has sustained a statute which laid an excise tax on incomes from certain businesses in excess of two hundred and fifty thousand dollars a year,² and has upheld taxes laid according to a progressive rate.³

There are many other striking inequalities possible under the present law, which have already

¹ Cf. *McCrary v. United States*, 195 U. S. 27; 24 Sup. Ct. Rep. 769.

² *Spreckels Sugar Refining Co. v. McClain*, 192 U. S. 397; 24 Sup. Ct. Rep. 376.

³ *Knowlton v. Moore*, 178 U. S. 41, 109; 20 Sup. Ct. Rep. 747; *Magoun v. Illinois Trust etc. Co.*, 170 U. S. 283, 293; 18 Sup. Ct. Rep. 594.

been adverted to; but probably none of them can be relied upon with any degree of confidence to impair the constitutionality of the statute. If, indeed, the Act should be construed to lay the tax on incomes received by corporations as trustees,¹ then truly the inequalities might well be held to be so great and glaring as to amount to a taking of property without due process of law. Even if the Act shall be so construed as to avoid that injustice, nevertheless it would seem to be liable to every objection on the score of inequality which was urged against the Income Tax Law of 1894, and, so far at least as four of the eight judges who participated in the first hearing, urged successfully.

§ 147. **As to Income from State and Municipal Securities.** — As explained above, the objections to the validity of this tax, so far as it applies to income received by corporations from state and municipal securities, would seem to be, to say the least, very formidable.² Congress is wholly without power to tax such securities, either directly or indirectly; and the tax in the present case is, it is submitted, if not a direct tax, at least an indirect one upon the income from such securities.

§ 148. **Retroactive Features.** — It is no objection to the validity of the law that it attempts

¹ As to this, see *supra* § 38.

² *Supra* § 40.

to tax income earned before its passage.¹ There is, however, some doubt whether it should be construed as having that effect.²

§ 149. **Consequences of Partial Unconstitutionality.** — Even if the tax sought to be imposed by this Act should be held to be unconstitutional in part, it would not necessarily follow that the whole should fall. The rule in such cases of partial unconstitutionality is simple enough, although often difficult of application: If the unconstitutional parts of the Act form so important a part of the whole, and are so intimately connected with the rest that it cannot be assumed that the legislature would have enacted the remaining provisions if it had been informed of the unconstitutionality of the others, then the courts will declare the whole inoperative; but if, on the other hand, the unconstitutional features are separable from the rest, and if there is no reason to doubt that the legislature would have wished the law to be carried out so far as can constitutionally be done, then the courts will not declare the whole act inoperative, but will enforce its provisions so far as they may be constitutional.

Now, applying these rules to the present case, we cannot doubt that the mere inability of Congress to tax so much of the income of companies subject to the Act as may be derived from state

¹ *Schuykill Nav. Co. v. Elliott*, 21 Fed. Cas. 762; *Stockdale v. Insurance Cos.*, 20 Wall. 323, 331.

² See *supra* § 39.

and municipal securities, is no reason why the tax should not be enforced as to income derived from other sources. Of course, if the tax should be held to be a tax upon state franchises, and therefore to be unconstitutional as a tax on the agencies of the state, or if it should be held to be so unequal in its operation as to amount to a taking of property without due process of law, it would be wholly void; but if those contingencies be passed by as too remote, the most radical view possible would be that the law is unconstitutional so far as it attempts to tax income from investments in real and personal property. Even then, there would seem to be no reason why the Act should not be held operative as to income from the carrying on of business. It is true that in *Pollock v. Farmers' Loan & Trust Co.*,¹ the Supreme Court held, though not without dissent, that a tax levied on all incomes would not be held operative as to such income as was derived from business or employments, but, being invalid as to income from real estate and from invested personal property, should be declared void altogether. But this decision is not in point in this respect, for the present tax is expressly laid "with respect to the carrying on or doing business," and even if those words should not be held sufficient, in view of the express language of other parts of the Act, to justify the courts in declaring that the tax is laid exclusively on the business of companies subject to

¹ 158 U. S. 601, 635-637; 15 Sup. Ct. Rep. 912.

the tax, and not upon their property as well as business, yet at least the words quoted do show that the taxing of the business was the chief object which Congress had in view. And as that chief object can be constitutionally carried out, there is no reason for declaring the whole Act to be void because some of the minor provisions, such as that for taxing income from invested capital, may be unconstitutional.

APPENDIX I

TEXT OF THE ACT OF CONGRESS

Reprinted from U. S. Stats., 61st Cong., 1st Sess., pp. 11, 112-117, 118.

CHAP. 6. An act to provide revenue, equalize duties and encourage the industries of the United States, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress Assembled,

.

[Paragraph One]

1 SEC. 38.¹ That every corporation, joint
2 stock company or association, organized for
3 profit and having a capital stock represented
4 by shares, and every insurance company, now
5 or hereafter organized under the laws of the
6 United States or of any State or Territory of
7 the United States or under the acts of Congress
8 applicable to Alaska or the District of Columbia,

¹The first paragraph of this section is not numbered, as the succeeding paragraphs are. It should be read, however, as Paragraph I, and is so cited in this book.

9 or now or hereafter organized under the laws
10 of any foreign country and engaged in business
11 in any State or Territory of the United States
12 or in Alaska or in the District of Columbia,
13 shall be subject to pay annually a special
14 excise tax with respect to the carrying on or
15 doing business by such corporation, joint stock
16 company or association, or insurance company,
17 equivalent to one per centum upon the entire
18 net income over and above five thousand dollars
19 received by it from all sources during such
20 year, exclusive of amounts received by it as
21 dividends upon stock of other corporations,
22 joint stock companies or associations, or in-
23 surance companies, subject to the tax hereby
24 imposed; or if organized under the laws of
25 any foreign country, upon the amount of net
26 income over and above five thousand dollars
27 received by it from business transacted and
28 capital invested within the United States and
29 its Territories, Alaska, and the District of
30 Columbia during such year, exclusive of
31 amounts so received by it as dividends upon
32 stock of other corporations, joint stock com-
33 panies or associations, or insurance companies,
34 subject to the tax hereby imposed: *Provided*,
35 *however*, That nothing in this section contained
36 shall apply to labor, agricultural or horticul-
37 tural organizations, or to fraternal beneficiary
38 societies, orders, or associations operating
39 under the lodge system, and providing for

40 the payment of life, sick, accident, and other
41 benefits to the members of such societies,
42 orders, or associations, and dependents of such
43 members, nor to domestic building and loan
44 associations, organized and operated exclusively
45 for the mutual benefit of their members, nor
46 to any corporation or association organized
47 and operated exclusively for religious, chari-
48 table, or educational purposes, no part of
49 the net income of which inures to the benefit
50 of any private stockholder or individual.

[Paragraph Two]

1 SECOND. Such net income shall be ascertained
2 by deducting from the gross amount of the
3 income of such corporation, joint stock com-
4 pany or association, or insurance company,
5 received within the year from all sources,
6 (first) all the ordinary and necessary expenses
7 actually paid within the year out of income
8 in the maintenance and operation of its busi-
9 ness and properties, including all charges such
10 as rentals or franchise payments, required to
11 be made as a condition to the continued use
12 or possession of property; (second) all losses
13 actually sustained within the year and not
14 compensated by insurance or otherwise, in-
15 cluding a reasonable allowance for deprecia-
16 tion of property, if any, and in the case of
17 insurance companies the sums other than
18 dividends, paid within the year on policy

19 and annuity contracts and the net addition,
20 if any, required by law to be made within the
21 year to reserve funds; (third) interest actually
22 paid within the year on its bonded or other
23 indebtedness to an amount of such bonded
24 and other indebtedness not exceeding the
25 paid-up capital stock of such corporation,
26 joint stock company or association, or in-
27 surance company, outstanding at the close
28 of the year, and in the case of a bank, banking
29 association, or trust company, all interest
30 actually paid by it within the year on deposits;
31 (fourth) all sums paid by it within the year
32 for taxes imposed under the authority of the
33 United States or of any State or Territory
34 thereof, or imposed by the government of
35 any foreign country as a condition to carrying
36 on business therein; (fifth) all amounts re-
37 ceived by it within the year as dividends
38 upon stock of other corporations, joint stock
39 companies or associations, or insurance com-
40 panies, subject to the tax hereby imposed:
41 *Provided*, That in the case of a corporation,
42 joint stock company or association, or insur-
43 ance company, organized under the laws of
44 a foreign country, such net income shall be
45 ascertained by deducting from the gross
46 amount of its income received within the
47 year from business transacted and capital
48 invested within the United States and any
49 of its Territories, Alaska, and the District of

50 Columbia, (first) all the ordinary and necessary
51 expenses actually paid within the year out
52 of earnings in the maintenance and operation
53 of its business and property within the United
54 States and its Territories, Alaska, and the
55 District of Columbia, including all charges
56 such as rentals or franchise payments required
57 to be made as a condition to the continued
58 use or possession of property; (second) all
59 losses actually sustained within the year in
60 business conducted by it within the United
61 States or its Territories, Alaska, or the Dis-
62 trict of Columbia not compensated by in-
63 surance or otherwise, including a reasonable
64 allowance for depreciation of property, if
65 any, and in the case of insurance companies
66 the sums other than dividends, paid within
67 the year on policy and annuity contracts
68 and the net addition, if any, required by law
69 to be made within the year to reserve funds;
70 (third) interest actually paid within the year
71 on its bonded or other indebtedness to an
72 amount of such bonded and other indebtedness,
73 not exceeding the proportion of its paid-up
74 capital stock outstanding at the close of the
75 year which the gross amount of its income
76 for the year from business transacted and
77 capital invested within the United States
78 and any of its Territories, Alaska, and the
79 District of Columbia bears to the gross amount
80 of its income derived from all sources within

81 and without the United States; (fourth) the
82 sums paid by it within the year for taxes
83 imposed under the authority of the United
84 States or of any State or Territory thereof;
85 (fifth) all amounts received by it within the
86 year as dividends upon stock of other corpora-
87 tions, joint stock companies or associations,
88 and insurance companies, subject to the
89 tax hereby imposed. In the case of assessment
90 insurance companies the actual deposit of
91 sums with State or Territorial officers, pur-
92 suant to law, as additions to guaranty or
93 reserve funds shall be treated as being pay-
94 ments required by law to reserve funds.

[Paragraph Three]

1 THIRD. There shall be deducted from the
2 amount of the net income of each of such
3 corporations, joint stock companies or associa-
4 tions, or insurance companies, ascertained as
5 provided in the foregoing paragraphs of this
6 section, the sum of five thousand dollars, and
7 said tax shall be computed upon the remainder
8 of said net income of such corporation, joint
9 stock company or association, or insurance com-
10 pany, for the year ending December thirty-first,
11 nineteen hundred and nine, and for each calen-
12 dar year thereafter; and on or before the first
13 day of March, nineteen hundred and ten, and
14 the first day of March in each year thereafter, a
15 true and accurate return under oath or affirma-

tion of its president, vice-president, or other principal officer, and its treasurer or assistant treasurer, shall be made by each of the corporations, joint stock companies or associations, and insurance companies, subject to the tax imposed by this section, to the collector of internal revenue for the district in which such corporation, joint stock company or association, or insurance company has its principal place of business, or, in the case of a corporation, joint stock company or association, or insurance company, organized under the laws of a foreign country, in the place where its principal business is carried on within the United States, in such form as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe, setting forth (first) the total amount of the paid-up capital stock of such corporation, joint stock company or association, or insurance company, outstanding at the close of the year; (second) the total amount of the bonded and other indebtedness of such corporation, joint stock company or association, or insurance company at the close of the year; (third) the gross amount of the income of such corporation, joint stock company or association, or insurance company, received during such year from all sources, and if organized under the laws of a foreign country the gross amount of its income received within

47 the year from business transacted and capital
48 invested within the United States and any of
49 its Territories, Alaska, and the District of
50 Columbia; also the amount received by such
51 corporation, joint stock company or association,
52 or insurance company, within the year by
53 way of dividends upon stock of other corpora-
54 tions, joint stock companies or associations, or
55 insurance companies, subject to the tax im-
56 posed by this section; (fourth) the total
57 amount of all the ordinary and necessary
58 expenses actually paid out of earnings in the
59 maintenance and operation of the business
60 and properties of such corporation, joint
61 stock company or association, or insurance
62 company, within the year, stating separately
63 all charges such as rentals or franchise pay-
64 ments required to be made as a condition to
65 the continued use or possession of property,
66 and if organized under the laws of a foreign
67 country the amount so paid in the maintenance
68 and operation of its business within the United
69 States and its Territories, Alaska, and the
70 District of Columbia; (fifth) the total amount
71 of all losses actually sustained during the
72 year and not compensated by insurance or
73 otherwise, stating separately any amounts al-
74 lowed for depreciation of property, and in the
75 case of insurance companies the sums other
76 than dividends, paid within the year on policy
77 and annuity contracts and the net addition,

78 if any, required by law to be made within the
79 year to reserve funds; and in the case of a
80 corporation, joint stock company or associa-
81 tion, or insurance company, organized under the
82 laws of a foreign country, all losses actually
83 sustained by it during the year in business
84 conducted by it within the United States or its
85 Territories, Alaska, and the District of Colum-
86 bia, not compensated by insurance or otherwise,
87 stating separately any amounts allowed for de-
88 preciation of property, and in the case of insur-
89 ance companies the sums other than dividends,
90 paid within the year on policy and annuity
91 contracts and the net addition, if any, required
92 by law to be made within the year to reserve
93 fund; (sixth) the amount of interest actually
94 paid within the year on its bonded or other
95 indebtedness to an amount of such bonded
96 and other indebtedness not exceeding the
97 paid-up capital stock of such corporation,
98 joint stock company or association, or insur-
99 ance company, outstanding at the close of
100 the year, and in the case of a bank, banking
101 association, or trust company, stating sepa-
102 rately all interest paid by it within the year
103 on deposits; or in case of a corporation, joint
104 stock company or association, or insurance
105 company, organized under the laws of a foreign
106 country, interest so paid on its bonded or
107 other indebtedness to an amount of such
108 bonded and other indebtedness not exceeding

109 the proportion of its paid-up capital stock
110 outstanding at the close of the year, which
111 the gross amount of its income for the year
112 from business transacted and capital invested
113 within the United States and any of its Terri-
114 tories, Alaska, and the District of Columbia,
115 bears to the gross amount of its income derived
116 from all sources within and without the United
117 States; (seventh) the amount paid by it within
118 the year for taxes imposed under the authority
119 of the United States or any State or Territory
120 thereof, and separately the amount so paid
121 by it for taxes imposed by the government
122 of any foreign country as a condition to carry-
123 ing on business therein; (eighth) the net
124 income of such corporation, joint stock com-
125 pany or association, or insurance company,
126 after making the deductions in this section
127 authorized. All such returns shall as received
128 be transmitted forthwith by the collector to
129 the Commissioner of Internal Revenue.

[Paragraph Four]

1 FOURTH. Whenever evidence shall be pro-
2 duced before the Commissioner of Internal
3 Revenue which in the opinion of the commis-
4 sioner justifies the belief that the return made
5 by any corporation, joint stock company or
6 association, or insurance company, is incor-
7 rect, or whenever any collector shall report
8 to the Commissioner of Internal Revenue

9 that any corporation, joint stock company or
10 association, or insurance company has failed
11 to make a return as required by law, the Com-
12 missioner of Internal Revenue may require
13 from the corporation, joint stock company or
14 association, or insurance company making
15 such return, such further information with
16 reference to its capital, income, losses, and
17 expenditures as he may deem expedient; and
18 the Commissioner of Internal Revenue, for
19 the purpose of ascertaining the correctness of
20 such return or for the purpose of making a
21 return where none has been made, is hereby
22 authorized, by any regularly appointed revenue
23 agent specially designated by him for that
24 purpose, to examine any books and papers
25 bearing upon the matters required to be in-
26 cluded in the return of such corporation, joint
27 stock company or association, or insurance
28 company, and to require the attendance of
29 any officer or employee of such corporation,
30 joint stock company or association, or insur-
31 ance company, and to take his testimony
32 with reference to the matter required by law
33 to be included in such return, with power to
34 administer oaths to such person or persons;
35 and the Commissioner of Internal Revenue
36 may also invoke the aid of any court of the
37 United States having jurisdiction to require
38 the attendance of such officers or employees
39 and the production of such books and papers.

40 Upon the information so acquired the Com-
41 missioner of Internal Revenue may amend
42 any return or make a return where none has
43 been made. All proceedings taken by the
44 Commissioner of Internal Revenue under the
45 provisions of this section shall be subject to
46 the approval of the Secretary of the Treasury.

[Paragraph Five]

1 FIFTH. All returns shall be retained by the
2 Commissioner of Internal Revenue, who shall
3 make assessments thereon; and in case of
4 any return made with false or fraudulent intent,
5 he shall add one hundred per centum of such
6 tax, and in case of a refusal or neglect to make
7 a return or to verify the same as aforesaid he
8 shall add fifty per centum of such tax. In
9 case of neglect occasioned by the sickness or
10 absence of an officer of such corporation, joint
11 stock company or association, or insurance
12 company, required to make said return, or for
13 other sufficient reason, the collector may allow
14 such further time for making and delivering
15 such return as he may deem necessary, not
16 exceeding thirty days. The amount so added
17 to the tax shall be collected at the same time
18 and in the same manner as the tax originally
19 assessed, unless the refusal, neglect, or falsity
20 is discovered after the date for payment of
21 said taxes, in which case the amount so added
22 shall be paid by the delinquent corporation,

23 joint stock company or association, or insur-
24 ance company, immediately upon notice given
25 by the collector. All assessments shall be made
26 and the several corporations, joint stock com-
27 panies or associations, or insurance companies,
28 shall be notified of the amount for which they
29 are respectively liable on or before the first
30 day of June of each successive year, and said
31 assessments shall be paid on or before the
32 thirtieth day of June, except in cases of refusal
33 or neglect to make such return, and in cases
34 of false or fraudulent returns, in which cases
35 the Commissioner of Internal Revenue shall,
36 upon the discovery thereof, at any time within
37 three years after said return is due, make a
38 return upon information obtained as above
39 provided for, and the assessment made by
40 the Commissioner of Internal Revenue thereon
41 shall be paid by such corporation, joint stock
42 company or association, or insurance company
43 immediately upon notification of the amount
44 of such assessment; and to any sum or sums
45 due and unpaid after the thirtieth day of
46 June in any year, and for ten days after notice
47 and demand thereof by the collector, there
48 shall be added the sum of five per centum on
49 the amount of tax unpaid and interest at the
50 rate of one per centum per month upon said
51 tax from the time the same becomes due.

[Paragraph Six]

1 SIXTH. When the assessment shall be made,
2 as provided in this section, the returns, to-
3 gether with any corrections thereof which may
4 have been made by the commissioner, shall
5 be filed in the office of the Commissioner of
6 Internal Revenue and shall constitute public
7 records and be open to inspection as such.

[Paragraph Seven]

1 SEVENTH. It shall be unlawful for any col-
2 lector, deputy collector, agent, clerk, or other
3 officer or employee of the United States to
4 divulge or make known in any manner what-
5 ever not provided by law to any person any
6 information obtained by him in the discharge
7 of his official duty, or to divulge or make
8 known in any manner not provided by law
9 any document received, evidence taken, or
10 report made under this section except upon the
11 special direction of the President; and any
12 offense against the foregoing provision shall
13 be a misdemeanor and be punished by a fine
14 not exceeding one thousand dollars, or by im-
15 prisonment not exceeding one year, or both,
16 at the discretion of the court.

[Paragraph Eight]

1 EIGHTH. If any of the corporations, joint
2 stock companies or associations, or insurance

3 companies aforesaid, shall refuse or neglect
4 to make a return at the time or times herein-
5 before specified in each year, or shall render a
6 false or fraudulent return, such corporation,
7 joint stock company or association, or insur-
8 ance company, shall be liable to a penalty of
9 not less than one thousand dollars and not
10 exceeding ten thousand dollars.

11 Any person authorized by law to make,
12 render, sign, or verify any return who makes
13 any false or fraudulent return, or statement,
14 with intent to defeat or evade the assessment
15 required by this section to be made, shall be
16 guilty of a misdemeanor, and shall be fined
17 not exceeding one thousand dollars or be
18 imprisoned not exceeding one year, or both,
19 at the discretion of the court, with the costs of
20 prosecution.

21 All laws relating to the collection, remission,
22 and refund of internal-revenue taxes, so far
23 as applicable to and not inconsistent with the
24 provisions of this section, are hereby extended
25 and made applicable to the tax imposed by
26 this section.

27 Jurisdiction is hereby conferred upon the
28 circuit and district courts of the United States
29 for the district within which any person sum-
30 moned under this section to appear to testify
31 or to produce books, as aforesaid, shall reside,
32 to compel such attendance, production of
33 books, and testimony by appropriate process.

- 1 SEC. 42. That unless otherwise herein
2 specially provided, this Act shall take effect on
3 the day following its passage.

Signed Five minutes after Five o'clock P.M.

August 5th, 1909.

W. H. T.

APPENDIX II

INTERNAL REVENUE REGULATIONS

PART I (T. D. 1571)

Regulations relating to the assessment and collection of the special excise tax imposed by section 38, act of August 5, 1909, on corporations, joint stock companies, associations, and insurance companies.

(Regulations No. 31)

Treasury Department,
Office of Commissioner of Internal Revenue,
WASHINGTON, D. C., December 3, 1909.

Section 38 of the act of August 5, 1909, is as follows:

(Here follows text of Section 38, for which see *supra* Appendix I.)

Article 1

The attention of collectors and others is specially called to the fact that the tax imposed by this sec-

tion of the law applies to all corporations, joint stock companies, associations, or insurance companies described (except those specifically exempted), without reference to the kind of business carried on, and that the tax is to be computed upon the *net income* of such corporations, joint stock companies, associations, and insurance companies, which shall be calculated by subtracting from the gross income received from all sources during the year certain deductions specifically set forth in the statute.

Every corporation, joint stock company, association, or insurance company not specifically enumerated as exempt shall make the return required by law, whether it may have net income liable to tax or not.¹

In the case of corporations, joint stock companies, associations, or insurance companies organized under the authority of the United States or any State or Territory thereof, including Alaska and District of Columbia, such net income relates not only to the business carried on within the confines of the United States, but to income received from business transacted in any foreign country as well.² In case of corporations, joint stock companies, and associations organized under the authority of foreign countries the terms "Gross income," "Net income," and "Authorized deductions" relate only

¹ As to the correctness of this construction of the Act, see *supra* § 87, § 72.

² See *supra* § 44A.

to business transacted ¹ within the United States or any State or Territory thereof.

Article 2 — *Gross income*

The following definitions and rules are given for determining the gross income of the various classes of corporations:

1A. *Banks and other financial institutions.* — Gross income consists of the gross revenue derived from the operation and management of the business and property of the corporation making the return, together with all amounts of income (including dividends received on stock of other corporations,² joint stock companies, associations, and insurance companies subject to this tax) derived from all other sources, as shown by the entries on its books³ from January 1 to December 31 of the year for which return is made.⁴

1B. *Insurance companies.* — Same as 1A above.

2. *Transportation companies.* — Same as 1A above.

3. *Manufacturing companies.* — Gross income received during the year from all sources will con-

¹ This apparently overlooks the words, "capital invested," which are found in the Act. See *supra* § 78, § 80 et seq.

² Cf. *supra* § 34.

³ *Quaere*, as to income entered on the books but not actually received. See *supra* § 37.

⁴ This, like many other parts of these regulations, assumes that income received during the year 1909 before the Act took effect is to be included. See *supra* § 39.

sist of the total amount, ascertained through an accounting, that shows the difference between the price received for the goods as sold and the cost of such goods as manufactured. The cost of goods manufactured shall be ascertained by an addition of a charge to the account of the cost of goods as manufactured during the year of the sum of the inventory at beginning of the year and a credit to the account of the sum of the inventory at the end of the year. To this amount should be added all items of income received during the year from other sources, including dividends received on stock of other corporations, joint stock companies, associations, and insurance companies subject to this tax. In the determination of the cost of goods manufactured and sold as above such cost shall comprehend all charges for maintenance and operation of manufacturing plant, but shall not embrace allowances for depreciation of property nor for losses sustained which are to be taken account of in ascertaining the net income subject to tax under the proper heading in the authorized deductions.¹

4. *Mercantile companies.* — Gross amount of income received during the year from all sources consists of the total amount ascertained through inventory, or its equivalent, which shows the difference between the price received for goods sold

¹ *Quaere*, why should there be this distinction between expenses of maintenance and operation, and allowances for depreciation of property, both of which are treated in the Act under the head of deductions? See *supra* § 46, § 53.

and the cost of goods purchased during the year, with an addition of a charge to the account of the sum of the inventory at beginning of the year and a credit to the account of the sum of the inventory at the end of the year. To this amount should be added all items of income received during the year from other sources inclusive of dividends received on stock of other corporations, joint stock companies, associations, and insurance companies subject to this tax. In determining this amount no account shall be taken of allowances for depreciation of property, nor for losses sustained which are to be taken account of in ascertaining the net income subject to tax under the proper heading in the authorized deductions.

5. *Miscellaneous.* — Gross income consists of the gross revenue derived from the operation and management of the business and property of the corporation making the return, together with all amounts of income (including dividends received on stock of other corporations, joint stock companies, associations, and insurance companies subject to this tax) derived from all other sources as shown by the entries on the books from January 1 to December 31 of the year for which return is made.

It will be noted from these definitions that gross income is practically the same as gross profits,¹ the only difference being that gross income is more inclusive, embracing as it does not only gross profits

¹ Quære, as to the correctness of this statement. See supra § 31.

of the corporation, joint stock company, and association itself, but also all amounts of income received from other sources. It is immaterial whether any item of gross income is evidenced by cash receipts during the year or in such other manner as to entitle it to proper entry on the books of the corporation from January 1 to December 31 for the year in which return is made.¹

*Sale of capital assets.*² — In ascertaining income derived from the sale of capital assets, if the assets were acquired subsequent to January 1, 1909, the difference between the selling price and the buying price shall constitute an item of gross income to be added to or subtracted from gross income according to whether the selling price was greater or less than the buying price. If the capital assets were acquired prior to January 1, 1909, the amount of increment or depreciation representing the difference between the selling and buying price is to be adjusted so as to fairly determine the proportion of the loss or gain arising subsequent to January 1, 1909,³ and which proportion shall be deducted from or added to the gross income for the year in which the sale was made. But for the purpose of determining the selling price, as provided in this section,

¹ This gives a liberal construction to the word "received." See *supra* § 37.

² Quaere as to the soundness of the views of the law on which this paragraph is based. See *supra* § 35.

³ In addition to the other objections to this regulation, it assumes that income received before the Act took effect is to be included in the assessment. Cf. *supra* § 39.

there shall be added to the price actually realized on sale any amount which has already been set aside and deducted from gross income by way of depreciation as defined in article 4 and has not been paid out in making good such depreciation on the property sold.

Where a corporation is engaged in carrying on more than one class of business, gross income derived from the different classes of business shall be ascertained according to the definitions above applicable thereto.

Article 3 — *Net income*

Net income shall be ascertained by deducting from the gross amount of the income of such corporation, joint stock company or association, or insurance company, received within the year from all sources, (first) all the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties, including all charges such as rentals or franchise payments, required to be made as a condition to the continued use or possession of property; (second) all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property, if any, and in the case of insurance companies the sums other than dividends paid within the year on policy and annuity contracts and the net addition, if any, required by law to be made within year to reserve funds; (third) interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and

other indebtedness not exceeding the paid-up capital stock of such corporation, joint stock company or association, or insurance company, outstanding at the close of the year, and in the case of a bank, banking association, or trust company, all interest actually paid by it within the year on deposits. [In case of corporations, joint stock companies, and associations organized under the laws of a foreign country, "the proportion of its paid-up capital stock outstanding at the close of the year which the gross amount of its income for the year from business transacted and capital invested within the United States and any of its Territories, Alaska, and the District of Columbia bears to the gross amount of its income derived from all sources within and without the United States"];¹ (fourth) all sums paid by it within the year for taxes imposed under the authority of the United States or of any State or Territory thereof, or imposed by the government of any foreign country as a condition to carrying on business therein; (fifth) all amounts received by it within the year as dividends upon stock of other corporations, joint stock companies or associations, or insurance companies, subject to the tax hereby imposed.

Section 38 further provides:

That in the case of a corporation, joint stock

¹ NOTE. — The matter included in brackets [] relates to interest actually paid within the year on "*bonded or other indebtedness*," and should be read in connection with the preceding provision (art. 3) relating to such interest paid by corporations, joint stock companies, etc., organized in the United States. (This note is by the Commissioner of Internal Revenue.)

company or association, or insurance company, organized under the laws of a foreign country, such net income shall be ascertained (by making like deductions) from the gross amount of its income received within the year from business transacted and its capital invested within the United States and any of its Territories, Alaska, and the District of Columbia.

Also that:

In the case of assessment insurance companies the actual deposit of sums with state or territorial officers, pursuant to law, as additions to guaranty or reserve fund, shall be treated as being payments required by law to reserve fund.

Also (third paragraph) that:

There shall be deducted from the amount of the net income of each of such corporations, joint stock companies or associations, or insurance companies, ascertained as provided in the foregoing paragraphs of this section, the sum of five thousand dollars.

The net income, therefore, is the remainder of the gross income after making the specified deductions.¹

Article 4. — Deductions

The specified deductions actually paid within the year, set forth in the statute and as described in article 3 preceding, shall include all proper items of expenses and charges under the respective heads as

¹ Quære, whether any deductions in addition to those specially required by the Act are permissible. See *supra* § 45.

designated. The amount returned for ordinary and necessary expenses actually paid within the year out of income in maintenance and operation of the business and properties of the corporation should not, however, embrace allowances for depreciation of fixed property which are otherwise to be taken account of under the proper heading in the authorized deductions, nor expenses paid within the year and charged to such allowances for depreciation credited in the current year or in previous years. In ascertaining expenses proper to be included in the deductions to be made under this article, corporations carrying materials and supplies on hand for use should include in such expenses the charges for materials and supplies only to the amount that the same are actually disbursed and used in operation and maintenance during the year for which the return is made.

It is immaterial whether the deductions are evidenced by actual disbursements in cash, or whether evidenced in such other way as to be properly acknowledged by the corporate officers and so entered on the books as to constitute a liability against the assets of the corporation, joint stock company, association, or insurance company making the return.¹

Losses. — The deduction for losses must be in respect of losses actually sustained during the year

¹ This is a liberal construction in favor of the corporations of the expression "actually paid." See *supra* § 49.

and not compensated by insurance or otherwise. It must be based upon the difference between the cost value and salvage value of the property or assets, including in the latter value such amount, if any, as has in the current or previous years been set aside and deducted from gross income by way of depreciation as defined in the following section and not been paid out in making good such depreciation.

Depreciation. — The deduction for depreciation should be the estimated amount of the loss, accrued during the year to which the return relates,¹ in the value of the property in respect of which such deduction is claimed that arises from exhaustion, wear and tear, or obsolescence out of the uses to which the property is put, and which loss has not been made good by payments for ordinary maintenance and repairs deducted under the heading of expenses of maintenance and operation or in the ascertainment of gross income. This estimate should be formed upon the assumed life of the property, its cost value, and its use. Expenses paid in any one year in making good exhaustion, wear and tear, or obsolescence in respect of which any deduction for depreciation is claimed must not be included in the deduction for expense of maintenance and operation of the property or in the ascertainment of gross income, but must be made out of accumulative allowances deducted for depreciation in current and previous years.

¹ As to this see *supra* § 57.

Article 5. — *Inventories*

It will be noted that an inventory or its equivalent of materials, supplies, and merchandise on hand for use or sale at the close of each calendar year is essential in the case of certain corporations in order to determine the gross income, and in case of other corporations to determine their expenses of operation. Where such inventory or its equivalent was not taken at the close of the year 1908, a supplemental statement showing such inventory approximately must be submitted with the return on the regular form.¹ Such supplemental statement shall be verified under oath by the treasurer or principal financial officer in submitting the same.

Where any item under any of the deductions is of an unusual nature a special explanatory note referring to such item shall be made and attached to the form at the appropriate place and made a part thereof by proper reference.²

Paragraph 3 of said section 38 also provides:

And said tax shall be computed upon the remainder of said net income of such corporation, joint stock company or association, or insurance company, for the year ending December thirty-first, nineteen hundred and nine, and for each calendar year thereafter; and on or before the first day of March,

¹ It is submitted that this requirement is unauthorized by law, and need not be obeyed. See *supra* § 90, § 100, § 101.

² As to the propriety of following such a course, see *supra* § 100.

nineteen hundred and ten, and the first day of March in each year thereafter, a true and accurate return under oath or affirmation of its president, vice-president, or other principal officer, and its treasurer or assistant treasurer, shall be made by each of the corporations, joint stock companies or associations, and insurance companies, subject to the tax imposed by this section, to the collector of internal revenue for the district in which such corporation, joint stock company or association, or insurance company, has its principal place of business, or, in the case of a corporation, joint stock company or association, or insurance company, organized under the laws of a foreign country, in the place where its principal business is carried on within the United States, in such form as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe.

Each return so made is required to set forth:

(a) The total amount of the paid-up capital stock of such corporations, joint stock companies or associations, or insurance companies, outstanding at the close of the year;

(b) The total amount of bonded and other indebtedness of such corporation, joint stock company or association, or insurance company, at the close of the year;

(c) The gross amount of the income of such corporation, joint stock company or association, or insurance company, received during the year from all sources, and if organized under the laws of a foreign country, the gross amount of its

income received within the year from business transacted and capital invested within the United States and any of its Territories, Alaska, and the District of Columbia.

Such returns are also required to set forth the items claimed as deductions (Article 4), also the net income after such deductions have been made.

Article 6

Under the authority conferred by this act forms of return have been prescribed,¹ in which the various items specified in the law are to be stated.

Blank forms of this return will be mailed to collectors and should be furnished to every corporation, not expressly excepted, on or before January 1, 1910, and on or before January 1st of each year thereafter. Failure on the part of any corporation, joint stock company, association, or insurance company liable to this tax, to receive a blank form will not excuse it from making the return required by law, or relieve it from any penalties for failure to make the return in the prescribed time.² Corporations not supplied with the proper forms for making the return should make application therefor to the collector of internal revenue in whose district is located its principal place of business. Each corporation should carefully prepare its return so as to fully and clearly set forth the data therein called for.

¹ For which see *infra* Appx. III.

² See *supra* § 86.

Bookkeeping. — No particular system of bookkeeping or accounting will be required by the Department. However, the business transacted by corporations, joint stock companies, associations, or insurance companies must be so recorded that each and every item therein set forth may be readily verified by an examination of the books and accounts, where such examination is deemed necessary.¹

Calendar year. — As the law specifically provides that the tax imposed shall be computed on the net income during each "*calendar year*," returns of income based on any period other than the calendar year can not be accepted.²

Corporations organized during the year or going into liquidation during the year should nevertheless render a sworn return on the prescribed form.³

Article 7

Collectors will see that as soon as each return made by any corporation is received a record on Form 632 is made, setting out the name of the corporation making the return, the nature of the principal business transacted, the location of principal place of business, with net income reported, and the date on which such return was received.

¹ It is submitted that the Treasury Department has no power to exact any such requirement. See *supra* § 90, § 100, § 101.

² See *supra* § 84A.

³ Cf. *supra* § 29.

The date of receipt in each case will be noted in the last column of that form, in which column the list on which assessment is made will also be noted. For this purpose the column so used may be subdivided, or the date of receipt of such returns may be noted in red ink over the date entered therein as to such assessment list.

Any collector will, whenever it appears advisable to do so, request that a revenue agent be specially designated to collect and furnish this office with such other data as, in his judgment, is necessary to determine the actual amount of tax to be assessed against any corporation, joint stock company, or association which under the law set forth in these regulations is required to make return.¹

Such returns are required to be made not later than March 1 of each year, and any failure to comply with the law in this regard should be at once reported by the collector to the Commissioner of Internal Revenue.²

To enable collectors to determine whether all returns due have been received, a careful canvass of each district should be made, and all corporations, joint stock companies, and associations subject to the tax imposed should be listed as above directed.³

¹ It seems clear that the Commissioner of Internal Revenue would not be justified in acting upon such a request unsupported by evidence. See *supra* § 106, § 110, § 134.

² Cf. *supra* § 86, § 130.

³ Cf. *supra* § 130.

Article 8

For statistical purposes all such corporations, joint stock companies, and associations will be classified as follows:

Class A: *Financial and commercial*. — Including banks, banking associations, trust companies, guaranty and surety companies, title insurance companies, building associations (if for profit), and insurance companies, not specifically exempt.

Class B: *Public service*. — Such as railroads, steamboat, ferryboat, and stage-line companies; pipe-line, gas, and electric-light companies; express, transportation, and storage companies; telegraph and telephone companies.

Class C: *Industrial and manufacturing*. — Such as mining, lumber, and coke companies; rolling mills; foundry and machine shops; saw-mills; flour, woolen, cotton, and other mills; manufacturers of cars, automobiles, elevators, agricultural implements, and all articles manufactured wholly or in part from metal, wood, or other material; manufacturers or refiners of sugar, molasses, sirups, or other products; ice and refrigerating companies; slaughterhouse, tannery, packing, or canning companies, etc.

Class D: *Mercantile*. — Including all dealers (not otherwise classed as producers or manufacturers) in coal, lumber, grain, produce, and all goods, wares, and merchandise.

Class E: *Miscellaneous*. — Such as architects, contractors, hotel, theater, or other companies, or associations, not otherwise classed.

When classified as above indicated the names of the various corporations, companies, and associations will be listed alphabetically, and will be numbered consecutively (commencing with No. 1 in *each* class), and in forwarding returns or papers subsequently rendered or submitted by such corporations or companies collectors will see that the same have placed thereon the designating class letter and number corresponding with those noted on the lists herein required to be furnished.

Article 9.—*Examination of books, etc., by revenue agents*

Paragraph 4 of said section 38 provides:

Fourth. Whenever evidence shall be produced before the Commissioner of Internal Revenue which in the opinion of the commissioner justifies the belief that the return made by any corporation, joint stock company or association, or insurance company, is incorrect, or whenever any collector shall report to the Commissioner of Internal Revenue that any corporation, joint stock company or association, or insurance company, has failed to make a return as required by law, the Commissioner of Internal Revenue may require from the corporation, joint stock company or association, or insurance company making such return, such further information with reference to its capital, income, losses, and expenditures as he may deem expedient; and the Commissioner of Internal Revenue, for the purpose of ascertaining the correctness of such return or for the purpose of making a return where none has been made, is hereby authorized,

by any regularly appointed revenue agent specially designated by him for that purpose, to examine any books and papers bearing upon the matters required to be included in the return of such corporation, joint stock company or association, or insurance company, and to require the attendance of any officer or employee of such corporation, joint stock company or association, or insurance company, and to take his testimony with reference to the matter required by law to be included in such return, with power to administer oaths to such person or persons; and the Commissioner of Internal Revenue may also invoke the aid of any court of the United States having jurisdiction to require the attendance of such officers or employees and the production of such books and papers. Upon the information so acquired the Commissioner of Internal Revenue may amend any return or make a return where none has been made. All proceedings taken by the Commissioner of Internal Revenue under the provisions of this section shall be subject to the approval of the Secretary of the Treasury.

Article 10. — *Assessment and collection of tax, etc.*

Paragraph 5 of said section 38 provides:

Fifth. All returns shall be retained by the Commissioner of Internal Revenue, who shall make assessments thereon; and in case of any return made with false or fraudulent intent, he shall add one hundred per centum of such tax, and in case of a refusal or neglect to make a return or to verify the same as aforesaid he shall add fifty per centum of such tax. In case of neglect occasioned by the sickness or absence of an officer of such corporation, joint stock company or association, or in-

insurance company, required to make said return, or for other sufficient reason, the collector may allow such further time for making and delivering such return as he may deem necessary, not exceeding thirty days. The amount so added to the tax shall be collected at the same time and in the same manner as the tax originally assessed unless the refusal, neglect, or falsity is discovered after the date for payment of said taxes, in which case the amount so added shall be paid by the delinquent corporation, joint stock company or association, or insurance company immediately upon notice given by the collector. All assessments shall be made and the several corporations, joint stock companies or associations, or insurance companies, shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year, and said assessments shall be paid on or before the thirtieth day of June, except in cases of refusal or neglect to make such return, and in cases of false or fraudulent returns, in which cases the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after said return is due, make a return upon information obtained as above provided for, and the assessment made by the Commissioner of Internal Revenue thereon shall be paid by such corporation, joint stock company or association, or insurance company immediately upon notification of the amount of such assessment; and to any sum or sums due and unpaid after the thirtieth day of June in any year, and for ten days after notice and demand thereof by the collector, there shall be added the sum of five per centum on the amount of tax unpaid and interest at the rate of one per centum per month upon said tax from the time the same becomes due.

Upon the receipt and verification of the returns rendered, the tax as ascertained to be due will be assessed as above prescribed; and notice of such assessment will be given and subsequent demand made (if necessary) on Forms 17 and 21, respectively.¹

In case of failure to make returns within the time and manner required by the statute, or where the return rendered is found or believed ² to be incorrect, action in such cases will be taken, as provided in paragraph 4 of the law.

The additional tax imposed by paragraph 5 of the law for failure to make the required return, or for making a false or fraudulent return, will in all cases be assessed as therein provided.

Article 11. — *Returns to constitute public records*

Paragraph 6 of said section 38 provides:

Sixth. When the assessment shall be made, as provided in this section, the returns, together with any corrections thereof which may have been made by the commissioner, shall be filed in the office of the Commissioner of Internal Revenue and shall constitute public records and be open to inspection as such.

¹ See *supra* § 123.

² This should be construed to mean "believed from evidence adduced before the Commissioner." See *supra* § 106, § 110, § 134.

Article 12. — *Penalties*

Paragraphs 7 and 8 of section 38 provide:

Seventh. It shall be unlawful for any collector, deputy collector, agent, clerk, or other officer or employee of the United States to divulge or make known in any manner whatever not provided by law to any person any information obtained by him in the discharge of his official duty, or to divulge or make known in any manner not provided by law any document received, evidence taken, or report made under this section except upon the special direction of the President; and any offense against the foregoing provision shall be a misdemeanor and be punished by a fine not exceeding one thousand dollars, or by imprisonment not exceeding one year, or both, at the discretion of the court.

Eighth. If any of the corporations, joint stock companies or associations, or insurance companies, aforesaid, shall refuse or neglect to make a return at the time or times hereinbefore specified in each year, or shall render a false or fraudulent return, such corporation, joint stock company or association, or insurance company, shall be liable to a penalty of not less than one thousand dollars and not exceeding ten thousand dollars.

Any person authorized by law to make, render, sign, or verify any return who makes any false or fraudulent return, or statement, with intent to defeat or evade the assessment required by this section to be made, shall be guilty of a misdemeanor, and shall be fined not exceeding one thousand dollars or be imprisoned not exceeding one year, or both, at the discretion of the courts, with the costs of prosecution.

Article 13. — *Certain revenue laws made applicable, and jurisdiction conferred on United States courts to compel attendance of witnesses, etc.*

Paragraph 8 further provides:

All laws relating to the collection, remission, and refund of internal-revenue taxes, so far as applicable to and not inconsistent with the provisions of this section, are hereby extended and made applicable to the tax imposed by this section.

Jurisdiction is hereby conferred upon the circuit and district courts of the United States for the district within which any person summoned under this section to appear to testify or to produce books, as aforesaid, shall reside, to compel such attendance, production of books, and testimony by appropriate process.

Article 14. — *Collection of tax*

The tax assessed under the provisions of this act will be collected and will be receipted for on Form 1, as in the case of other assessed taxes. Unless paid within the time fixed by the statute, notice and demand should be at once issued, and, in case of nonpayment, distraint proceedings should be instituted without delay.

ROYAL E. CABELL, *Commissioner.*

Approved:

FRANKLIN MACVEAGH, *Secretary of the Treasury.*

PART II

(T. D. 1578)

Excise Tax

Corporations to render returns to collectors of internal revenue for the calendar year 1909 and each calendar year thereafter. — Actual inventories required only when taxable net income can not be stated otherwise. — Book inventories, or statements therefrom equivalent to inventories, permissible when showing the real taxable income.

Treasury Department,
Office of Commissioner Internal Revenue,
Washington, D. C., January 4, 1910.

To collectors of internal revenue and others interested:

Many inquiries have been made at this office concerning the requirements of section 38, act of August 5, 1909, levying an excise tax of 1 per cent of the total net income over \$5,000 of corporations, as to the time that must be covered by the returns of such corporations.

In order that the position of this office may be known to all interested in this subject, attention is invited to the language of the act bearing on this point. Subdivision 3 reads, in part, as follows:

. . . and said tax shall be computed upon the remainder of said net income of such corporation, joint stock company or association, or insurance company, for the year ending December thirty-first, nineteen hundred and nine, and for each calendar year thereafter.

From this it will be seen that the law fixes the calendar year as the period to be covered by these returns,¹ and no one is vested with discretionary power to change it.

Many inquiries have been submitted as to the manner of arriving at an inventory January 1, 1909, when none was taken on that date and where the fiscal year of the corporation ends with a date other than December 31.

In article 5 of Regulations No. 31 it is stated that an inventory or its equivalent of materials, supplies, and merchandise on hand for use or sale at the close of each calendar year is essential in the case of certain corporations in order to determine the gross income, and in case of other corporations to determine their expenses of operation. Where such inventory or its equivalent was not taken at the close of the year 1908, a supplemental statement showing such inventory approximately must be submitted with the return on the regular form. Such supplemental statement shall be verified under oath, etc.

Under the statute no return for a period other than the calendar year can be accepted. The primary object to be kept in view is the preparation of a statement or return which shall correctly set forth the net income taxable under the law. If this

¹ See *supra* § 84A. These regulations assume that the tax is to be computed upon the income of the entire year 1909 and not upon only so much thereof as elapsed after the statute took effect. As to the correctness of this assumption, see *supra* § 29, § 39.

can be accomplished without the necessity of an inventory, either at the beginning or the close of the calendar year, actual inventories are not necessary. If, however, a statement such as may be verified by oath of the officers of the corporation, showing the net taxable income, can not be made without an inventory, then the same is necessarily required.¹

It is believed that corporations whose business is of sufficient volume to produce a taxable income under this law would ordinarily keep such books as would enable them to arrive at a book inventory, or what might be termed the "equivalent" of an inventory, for the period between the 1st of January and the end of their fiscal years. While the office is unable to set forth any rule in this connection for arriving at inventories or their equivalents, the corporations will readily see the necessity of resorting to the best means at their hands to show in their sworn returns their net taxable income.

ROYAL E. CABELL, *Commissioner*.

¹ This clause indicates somewhat of a recession from the absolute requirement of an inventory attempted to be prescribed in the Regulations of Dec. 3d, 1909. As stated above, it is submitted that no such requirement could be enforced. See *supra* § 100. As to the course to be pursued where the company is unable to make an accurate return see § 101. The maxim, *lex non cogit ad impossibilia*, would seem to govern such cases.

APPENDIX III. FORMS OF RETURNS
PRESCRIBED BY THE TREASURY DEPARTMENT

Form No. 634.

TO BE FILLED IN BY COLLECTORS:

List No. TO BE FILLED IN BY INTERNAL REVENUE BUREAU.
Class *Assessment List* 19...
..... *District of* *Page* *Line*
..... *Date received* 19...

UNITED STATES INTERNAL REVENUE.

RETURN OF ANNUAL NET INCOME.

(Section 38, Act of Congress approved August 5, 1909.)

INSURANCE COMPANIES.

RETURN OF NET INCOME received during the Year ending December 31, 19...., by
which is located at....., *a corporation, the principal place of business of*
....., *in the State of*.....

1. Total amount of paid-up stock outstanding at close of year \$.....
2. Total amount of bonded or other indebtedness outstanding at close of year \$.....
3. GROSS INCOME (see Note A) \$.....

DEDUCTIONS.

4. Total amount of all the ordinary and necessary expenses of maintenance and operation of the business and properties of the corporation (see Note B) .. \$.....
5. (a) Total amount of losses sustained January 1 to December 31..... \$.....
- (b) Total amount of depreciation January 1 to December 31..... \$.....
- (c) Total amount other than dividends paid within the year on policy and annuity contracts..... \$.....
- (d) Total amount of net addition required by law to be made within the year to reserve fund..... \$.....
- Total (see Note B)..... \$.....
6. Total amount of interest January 1 to December 31 on bonded indebtedness to an amount not to exceed amount of paid-up capital at close of year (see Note B)..... \$.....
7. (a) Total taxes paid January 1 to December 31 imposed under authority of the United States or any State or Territory thereof..... \$.....
- (b) Foreign taxes paid..... \$.....
- Total (see Note B)..... \$.....

8.	Amount received by way of dividends upon stock of other corporations, joint-stock companies, associations, and insurance companies subject to this tax.	\$
	TOTAL DEDUCTIONS	\$
9.	NET INCOME	\$
10.	Specific deductions from net income allowed by law	\$5,000.00
11.	Amount on which tax at one per centum is to be calculated for assessment.	\$

STATE OF } TO WIT:
County of }

the corporation, whose return of annual net income is set forth above, being severally duly sworn, each for himself, deposes and says that the foregoing report and the several items therein set forth are, to his best knowledge and belief and from such information as he has been able to obtain, true and correct in each and every particular; that the amount of gross income therein set forth is the full amount of gross income, without any deductions whatsoever, received from all sources by the said corporation during the year stated, and that the net income therein set forth is the full amount on which the tax is proper to be assessed

SWORN AND SUBSCRIBED to before me this
day of, 19....
President.

[SEAL.]
Treasurer.

NOTE A. — The gross income shall consist of the total of the gross revenue derived from the operation and management of its business and properties, together with all amounts of income, including dividends on stock of organizations to this special excise tax from other sources as shown by the entries on its books from January 1 to December 31 of the year for which return is made.

NOTE B. — The deductions authorized shall include all expense items under the various heads acknowledged as liabilities by the corporation making the return and entered on its books from January 1 to December 31.

NOTE C. — THIS FORM, PROPERLY FILLED OUT AND EXECUTED, MUST BE IN THE HANDS OF THE COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT IN WHICH IS LOCATED THE PRINCIPAL OFFICE OF THE CORPORATION MAKING THE RETURN, ON OR BEFORE MARCH 1.

Form No. 635.

TO BE FILLED IN BY COLLECTORS.

List No.
Class
District of
Page
Date received
Line
Assessment List
TO BE FILLED IN BY INTERNAL REVENUE BUREAU.

UNITED STATES INTERNAL REVENUE.

RETURN OF ANNUAL NET INCOME.

(Section 38, Act of Congress approved August 5, 1909.)

BANKS AND OTHER FINANCIAL INSTITUTIONS.

RETURN OF NET INCOME received during the Year ending December 31, 19....., by....., which is located at....., a corporation, the principal place of business of..... in the State of.....
 1. Total amount of paid-up stock outstanding at close of year..... \$.....
 2. Total amount of bonded or other indebtedness outstanding at close of year..... \$.....
 3. GROSS INCOME (see Note A)..... \$.....

DEDUCTIONS.

4. Total amount of all the ordinary and necessary expenses of maintenance and operation of the business and properties of the corporation (see Note B)..... \$.....
 5. (a) Total amount of losses sustained January 1 to December 31..... \$.....
 (b) Total amount of depreciation January 1 to December 31..... \$.....
 TOTAL (see Note B)..... \$.....
 6. (a) Total amount of interest January 1 to December 31 on bonded or other indebtedness to an amount not to exceed amount of paid-up capital at close of year (see Note B)..... \$.....
 (b) Total amount of interest paid within the year on deposits..... \$.....
 TOTAL (see Note B)..... \$.....
 7. (a) Total taxes paid January 1 to December 31 imposed under authority of the United States or any State or Territory thereof..... \$.....
 (b) Foreign taxes paid..... \$.....
 TOTAL (see Note B)..... \$.....

8. Amount received by way of dividends upon stock of other corporations, joint-stock companies, associations, and insurance companies subject to this tax \$.....
- TOTAL DEDUCTIONS..... \$.....
9. NET INCOME..... \$.....
10. Specific deduction from net income allowed by law..... \$.....
11. Amount on which tax at one per centum is to be calculated for assessment..... \$5,000.00

STATE OF } TO WIT:
 County of

....., President, and Treasurer, of the corporation, whose return of annual net income is set forth above, being severally duly sworn, each for himself, deposes and says that the foregoing report and the several items therein set forth are, to his best knowledge and belief and from such information as he has been able to obtain, true and correct in each and every particular; that the amount of gross income therein set forth is the full amount of the gross income, without any deduction whatsoever, received from all sources by the said corporation during the year stated, and that the net income therein set forth is the full amount on which tax is proper to be assessed.

SWORN AND SUBSCRIBED to before me this
 day of, 19....
 President.

..... [SEAL.]

..... Treasurer.

NOTE A. — Gross income shall consist of the total amount of gross revenue derived from the operation and management of its business and properties, together with all amounts of income, including dividends on stock of other corporations, joint-stock companies, and associations subject to this tax, derived from all sources as shown by the entries on its books from January 1 to December 31 of the year for which return is made.

NOTE B. — The deductions authorized shall include all expense items under the various heads acknowledged as liabilities by the corporation making the return and entered assuch on its books from January 1 to December 31.

NOTE C. — THIS FORM, PROPERLY FILLED OUT AND EXECUTED, MUST BE IN THE HANDS OF THE COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT IN WHICH IS LOCATED THE PRINCIPAL OFFICE OF THE CORPORATION MAKING THE RETURN, ON OR BEFORE MARCH 1.

Form No. 636.

TO BE FILLED IN BY COLLECTORS.

List No.

Class

District of

TO BE FILLED IN BY INTERNAL REVENUE BUREAU.

Assessment List

Page

Date received

UNITED STATES INTERNAL REVENUE.

RETURN OF ANNUAL NET INCOME.

(Section 38, Act of Congress approved August 5, 1909.)

TRANSPORTATION CORPORATIONS.

RETURN OF NET INCOME received during the Year ending December 31, 19....., by....., *a corporation, the principal place of business of which is located at, in the State of*

1. Total amount of paid-up stock outstanding at close of year
2. Total amount of bonded or other indebtedness outstanding at close of year
3. GROSS INCOME (see Note A)

DEDUCTIONS.

4. Total amount of all the ordinary and necessary expenses of maintenance and operation of the business and properties of the corporation (see Note B) ..
5. (a) Total amount of losses sustained January 1 to December 31 ..
- (b) Total amount of depreciation January 1 to December 31 ..
6. Total amount of interest January 1 to December 31 ..
- edness to an amount not to exceed amount of paid-up capital at close of year (see Note B) ..
7. (a) Total taxes paid January 1 to December 31 imposed under authority of the United States or any State or Territory thereof ..
- (b) Foreign taxes paid ..
- TOTAL (see Note B) ..
8. Amount received by way of dividends upon stock of other corporations, joint-stock companies, associations, and insurance companies subject to this tax ..
- TOTAL DEDUCTIONS ..

9. NET INCOME \$
 Specific deductions from net income allowed by law \$5,000.00
 10. Amount on which tax at one per centum is to be calculated for assessment \$

STATE OF } TO WIT:
 County of

....., President, and Treasurer, of the corporation, whose return of annual net income is set forth above, being severally duly sworn, each for himself, deposes and says that the foregoing report and the several items therein set forth are, to his best knowledge and belief and from such information as he has been able to obtain, true and correct in each and every particular; that the amount of gross income therein set forth is the full amount of gross income, without any deduction whatsoever, received from all sources by the said corporation during the year stated, and that the net income therein set forth is the full amount on which tax is proper to be assessed.

SWORN AND SUBSCRIBED to before me this
 day of, 19....

..... President.

[SEAL.]

..... Treasurer.

NOTE A. — Gross income shall consist of the gross revenue derived from the operation and management of the business and property of the corporation making the return, together with all amounts of income (including dividends received on stock of other corporations, joint-stock companies, and associations subject to this tax) derived from all sources as shown by the entries on its books from January 1 to December 31, of the year for which return is made.

NOTE B. — The deductions authorized shall include all expense items under the various heads acknowledged as liabilities by the corporation making the return and entered as such on its books from January 1 to December 31 of the year for which return is made.

NOTE C. — THIS FORM, PROPERLY FILLED OUT AND EXECUTED, MUST BE IN THE HANDS OF THE COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT IN WHICH IS LOCATED THE PRINCIPAL OFFICE OF THE CORPORATION MAKING THE RETURN, ON OR BEFORE MARCH 1.

Form No. 637.

TO BE FILLED IN BY COLLECTORS.

TO BE FILLED IN BY INTERNAL REVENUE BUREAU.

List No.

Assessment List

Page

Line

Date received

19

District of

UNITED STATES INTERNAL REVENUE.

RETURN OF ANNUAL NET INCOME.

(Section 38, Act of Congress approved August 5, 1909.)

MANUFACTURING CORPORATIONS.

RETURN OF NET INCOME received during the Year ending December 31, 19, by, which is located at, a corporation, the principal place of business of in the State of

1. Total amount of paid-up stock outstanding at close of year \$

2. Total amount of bonded or other indebtedness outstanding at close of year \$

3. Gross INCOME (see Note A) \$

DEDUCTIONS.

4. Total amount of all the ordinary and necessary expenses of maintenance and operation of the business and properties of the corporation (see Note B) \$

5. (a) Total amount of losses sustained January 1 to December 31 \$

(b) Total amount of depreciation January 1 to December 31 \$

TOTAL (see Note B) \$

6. Total amount of interest January 1 to December 31 on bonded or other indebtedness to an amount not to exceed amount of paid-up capital at close of year (see Note B) \$

7. (a) Total taxes paid January 1 to December 31 imposed under authority of the United States or any State or Territory thereof \$

(b) Foreign taxes paid \$

TOTAL (see Note B) \$

8. Amount received by way of dividends upon stock of other corporations, joint-stock companies, associations, and insurance companies subject to this tax \$

TOTAL DEDUCTIONS \$

9. NET INCOME \$

10. Specific deduction from net income allowed by law..... \$5,000.00
 11. Amount on which tax at one per centum is to be calculated..... \$.....

STATE OF } TO WIT:
 County of

....., President, and
 the corporation, whose return of annual net income is set forth above, being severally
 duly sworn, each for himself, deposes and says that the foregoing report and the several items therein set
 forth are, to his best knowledge and belief and from such information as he has been able to obtain, true
 and correct in each and every particular; that the amount of gross income therein set forth is the full amount
 of gross income, without any deduction whatsoever, received from all sources by the said corporation during
 the year stated, and that the net income therein set forth is the full amount on which the tax is proper to
 be assessed.

SWORN AND SUBSCRIBED to before me this
 day of, 19.....

.....
President.

[SEAL.]

.....
Treasurer.

NOTE A. — The gross income received during the year from all sources shall in the case of a manu-
 facturing corporation consist of the total amount ascertained through an accounting that shows the differ-
 ence between the price received for the goods as sold and the cost of such goods as manufactured. The
 cost of goods manufactured shall be ascertained by an addition of a charge to the account of the cost of
 goods as manufactured during the year, of the sum of the inventory at beginning of the year and a credit
 to the account of the sum of the inventory at the end of the year. To this amount should be added
 items of income received during the year from other sources, including dividends received on stock of other
 corporations, joint-stock companies, and associations subject to this tax. In the determination of the cost
 of goods manufactured and sold as above such cost shall comprehend all charges for maintenance and
 operation of manufacturing plant, but shall not embrace allowances for depreciation or losses, which items
 shall be taken account of under the proper heading above as a deduction.

NOTE B. — The deductions authorized shall include all expense items under the various heads ac-
 knowledged as liabilities by the corporation making the return and entered as such on its books from
 January 1 to December 31 of the year for which return is made.

NOTE C. — THIS FORM, PROPERLY FILLED OUT AND EXECUTED, MUST BE IN THE HANDS OF THE
 COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT IN WHICH IS LOCATED THE PRINCIPAL OFFICE OF THE
 CORPORATION MAKING THE RETURN, ON OR BEFORE MARCH 1.

Form No. 638.

TO BE FILLED IN BY COLLECTORS	TO BE FILLED IN BY INTERNAL REVENUE BUREAU.
List No.	Assessment List
Class	Page
..... District of	Line
	Date received and filed....., 19.....

UNITED STATES INTERNAL REVENUE.

RETURN OF ANNUAL NET INCOME.

(Section 38, Act of Congress approved August 5, 1909.)

MISCELLANEOUS CORPORATIONS.

RETURN OF NET INCOME received during the Year ending December 31, 19....., by....., which is located at....., a corporation, the principal place of business of....., in the State of.....

1. Total amount of paid-up stock outstanding at close of year..... \$.....
2. Total amount of bonded or other indebtedness outstanding at close of year..... \$.....
3. GROSS INCOME (see Note A)..... \$.....

DEDUCTIONS.

4. Total amount of all the ordinary and necessary expenses of maintenance and operation of the business and properties of the corporation (see Note B) .. \$.....
5. (a) Total amount of loss sustained January 1 to December 31..... \$.....
(b) Total amount of depreciation, January 1 to December 31..... \$.....
TOTAL (see Note B)..... \$.....
6. Total amount of interest January 1 to December 31 on bonded indebtedness to an amount not to exceed amount of paid-up capital at close of year (see Note B)..... \$.....
7. (a) Total taxes paid January 1 to December 31 imposed under authority of the United States or any State or Territory thereof.... \$.....
(b) Foreign taxes paid..... \$.....
TOTAL (see Note B)..... \$.....

- | | | |
|-----|---|------------|
| 8. | Amount received by way of dividends upon stock of other corporations, joint-stock companies, associations, and insurance companies subject to this tax \$ | \$ |
| | TOTAL DEDUCTIONS | \$ |
| 9. | NET INCOME | \$ |
| 10. | Specific deduction from net income allowed by law | \$5,000.00 |
| 11. | Amount on which tax at one per centum is to be calculated. | \$ |

STATE OF } **TO WIT:**

County of President, and Treasurer, of
..... corporation, whose return of annual net income is set forth above, being severally
the duly sworn, each for himself, deposes and says that the foregoing report and the several items therein set
forth are, to his best knowledge and belief and from such information as he has been able to obtain, true and
correct in each and every particular; that the amount of gross income therein set forth is the full amount of
gross income, without any deduction, whatsoever received from all sources by the said corporation during
the year stated and that the net income therein set forth is the full amount on which tax is proper to be
assessed.

assessed.
 SWORN AND SUBSCRIBED to before me this.....
 day of, 19....

President.

[SEAL.]

Treasurer.

NOTE A. — Gross income shall consist of the total of the gross revenue derived from the operation and management of its business and properties, together with all amounts of income from other sources, including dividends on stock of other organizations subject to this special excise tax received, as shown by the books from January 1 to December 31 of the year for which return is made.

NOTE B.—The deductions authorized shall include all expense items under the various heads accounts upon its books from January 1 to December 31 of the year for which return is made.

NOTE C.—THIS FORM, PROPERLY FILLED OUT AND EXECUTED, MUST BE IN THE HANDS OF THE COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT IN WHICH IS LOCATED THE PRINCIPAL OFFICE OF THE CORPORATION MAKING THE RETURN, ON OR BEFORE MARCH 1.

TO BE FILLED IN BY COLLECTORS.

TO BE FILLED IN BY INTERNAL REVENUE BUREAU.

List No. _____ TO BE FILLED

Assessment List

SECRET OF POLYMER FILMS
61

Class

Page Line

..... *District of*

Date received..... 19.....

UNITED STATES INTERNAL REVENUE.

RETURN OF ANNUAL NET INCOME.

(Section 38, Act of Congress approved August 5, 1909.)

MERCANTILE
CORPORATIONS.

(Corporations whose principal business is buying and selling.)

RETURN OF NET INCOME received during the Year ending December 31, 19...., by, a corporation, the principal place of business of, in the State of

- | | | |
|----|--|---------|
| 1. | Total amount of paid-up stock outstanding at close of year..... | \$..... |
| 2. | Total amount of bonded or other indebtedness outstanding at close of year..... | \$..... |
| 3. | GROSS INCOME (see Note A)..... | \$..... |

DEDUCTIONS.

- | | | |
|----|---|-----|
| 4. | Total amount of all the ordinary and necessary expenses of maintenance and operation of the business and properties of the corporation (see Note B) .. | \$. |
| 5. | (a) Total amount of losses sustained January 1 to December 31 .. | \$. |
| | (b) Total amount of depreciation January 1 to December 31 .. | \$. |
| | Total (see Note B) .. | \$. |
| 6. | Total amount of interest January 1 to December 31 on bonded or other indebtedness to an amount not to exceed amount of paid-up capital at close of year (see Note B) .. | \$. |
| 7. | (a) Total taxes paid January 1 to December 31 imposed under authority of the United States or any State or Territory thereof .. | \$. |
| | (b) Foreign taxes paid .. | \$. |
| | Total (see Note B) .. | \$. |
| 8. | Amount received by way of dividends upon stock of other corporations, joint-stock companies, associations, and insurance companies subject to this tax .. | \$. |
| | Total Deductions .. | \$. |

- | | | |
|-----|--|------------|
| 9. | NET INCOME | \$ |
| 10. | Specific deduction from net income allowed by law | \$5,000.00 |
| 11. | Amount on which tax at one per centum is to be calculated for assessment | \$ |

County of } President, and Treasurer, of
the corporation, whose return of annual net income is set forth above, being severally
duly sworn, each for himself, deposes and says that the foregoing report and the several items therein set
forth are to his best knowledge and belief, and from such information as he has been able to obtain, true and
correct in each and every particular; that the amount of gross income therein set forth is the full amount
of gross income without any deduction whatsoever received from all sources by the said corporation during
the year stated, and that the net income therein set forth is the full amount on which the tax is proper to
be assessed.

SWORN AND SUBSCRIBED to before me this
 day of, 19....
 *President.*

[SEAL.]

Treasurer.

NOTE A. — The gross amount of income received during the year from all sources shall in the case of a mercantile corporation consist of the total amount ascertained through inventory, or its equivalent, which shows the difference between the price received for goods sold and the cost of goods purchased during the year, with an addition of a charge to the account of the sum of the inventory at beginning of the year and a credit to the account of the sum of the inventory at the end of the year. To this amount should be added all items of income received during the year from other sources, including dividends received on stock of other corporations, joint-stock companies, and associations subject to this tax. In determining this amount no account shall be taken of allowances for depreciation or losses, which items shall be taken account of under the proper heading above as a deduction.

NOTE B. — The deductions authorized shall include all expense items under the various heads of count of under the proper heading above as a deduction.

acknowledged as liabilities by the corporation making the return and entered as such on its books from January 1 to December 31 of the year for which return is made.

NOTE C.—THIS FORM, PROPERLY FILLED OUT AND EXECUTED, MUST BE IN THE HANDS OF THE COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT IN WHICH IS LOCATED THE PRINCIPAL OFFICE OF THE CORPORATION MAKING THE RETURN, ON OR BEFORE MARCH 1.

INDEX

[References are to sections]

A

SECTION

ACT OF CONGRESS LEVYING CORPORATION	
TAX. (See also CONSTITUTIONALITY OF THE ACT	
OF CONGRESS.)	
title of	3
purpose of	3
how cited and referred to in this book	2
form of	2
discordant provisions of, with respect to what the	
tax is on	5, 9
when became effective	29
provisions of, prescribing method of calculating	
income, mandatory	32
whether retroactive	29, 39
whether list in, of deductions to be made from	
gross income is exhaustive	45
See also DEDUCTIONS TO BE MADE FROM	
GROSS INCOME.	
deductions allowed by, from gross income,	
See DEDUCTIONS TO BE MADE FROM GROSS IN-	
COME.	
ACTION. (See REMEDIES.)	
ACTION OF DEBT	
to recover tax, limitation of time for instituting .	113n.
as means of correcting erroneous return . . .	114, 126
where no assessment has been made	114, 122, 126
may be defended without first appealing to	
Commissioner of Internal Revenue	137

[References are to sections]

SECTION

ACTION OF DEBT — *Continued*

to collect an assessment 126

APPORTIONMENT

of earnings between business transacted in United
States and abroad 77

ASSESSMENT

to be made by Commissioner on facts as stated in
return 103, 119, 120, 134

acquiesced in by government, presumed correct . 113n.

whether condition precedent to action of debt to

recover tax 114

necessity for 114

nature of Commissioner's duty in making 103, 120, 134

amount of 121

time of 122

on original return 103, 119, 120, 121

on corrected return 119, 120, 121, 122

notice of 123, 130

payment of 123

See also PAYMENT.

distinguished from collection 125, 129, 130

collection of,

See COLLECTION.

general statutes as to, not applicable to this tax
125, 129, 130

mandamus to compel 134

ASSESSMENTS, SPECIAL. (See SPECIAL ASSESS-
MENTS.)

ASSETS

increase in value of, not necessarily income . . 31, 35

B

BANKS

tax on deposits of 40, 40n.

interest on deposits of, when deductible from

gross income 67

[References are to sections]

SECTION

BANKS — *Continued*

what are	67n.
capital of, what is	78n.
foreign, not allowed to deduct interest on deposits in excess of paid-up capital	82

BONDS

held by foreign company, when deemed capital invested in United States	78
---	----

BOOKS

company cannot be required to change its mode of keeping	101
company not bound to keep	101
examination of, by revenue agents	108, 109
court proceedings to compel production of	109
defences to	110
costs of	111
general statute as to production of, to collectors, inapplicable	130

BREWERIES

what may be treated as operating expenses of	47n.
---	------

BUSINESS

taxes on, proportioned to dividends and interest on bonded debt	4n.
is this tax laid on	4-10, 48
this tax not proportioned to amount of	5, 10, 42, 149
this tax designated by Congress as a tax on	6, 48
is income used a mere measure of the	7-10, 14, 48
whether companies which do no, are liable to this tax	9
character of, classification of corporations with respect to	18
when a corporation is engaged in, within United States	28
tax on, whether affected by ownership of property exempt from taxation	40

[References are to sections]

SECTION

BUSINESS — *Continued*

what is income from, as distinguished from income from investments	43
expenses of maintaining and operating	46-52
See MAINTENANCE AND OPERATION.	
what is income from, transacted in United States	76, 77
what is loss in a given	81n.
principal place of, return to be made at	89
tax on income derived from, not a direct tax	142

BUSINESS CORPORATION

whether equivalent to corporation organized for profit	17
whether educational corporation charging for tuition is	26

C**CAPITAL. (See also CAPITAL STOCK.)**

invested, income from	5, 10, 78, 41, 42
invested in United States, what is income from	78
employed, what is	78n.
circulating and fixed, distinction between	35, 53
and surplus, what is	43n.
what expenses properly chargeable to	

See DEDUCTIONS TO BE MADE FROM GROSS INCOME.

income charges paid by, recoupment for	50
loss of,	

See Loss.

CAPITAL STOCK

divided into shares, whether this tax is on privilege of having	12
what corporations have	19
meaning of	61
paid-up, what is	61
outstanding, what is	63

[References are to sections]

SECTION

CAPITAL STOCK — *Continued*

what return must state in regard to 91

CHARITABLE CORPORATION

what is 18n., 26

whether exempt from this tax 26

COLLECTION. (See also COLLECTORS.)

distinguished from assessment 125, 129, 130

governed by general internal revenue statutes 125

by distraint, etc. 125

by action of debt, (See ACTION OF DEBT.)

COLLECTORS

may extend time for making return 86

whether may administer oath to return 88, 130

to receive returns 89

to transmit returns to Commissioner of Internal
Revenue 102

to report to Commissioner failure of company
to make return 104

duties of, in case return submitted is imperfect
on its face 105

to report errors in return 106

to serve notice of assessment 123

to receive payment of the tax 123

directions to, by Secretary of Treasury 128

not inquisitorial officers in connection with this
tax 128, 130

general duties of 130

not to divulge information 117, 130

actions against, to recover back taxes paid under
protest 137

COMMISSIONER OF INTERNAL REVENUE

no power to prepare return for corporation not in
default 29

regulations of,
as to liability to this tax of corporations
organized or dissolved within the year 29

[References are to sections]

SECTION

COMMISSIONER OF INTERNAL REVENUE —

Continued

as to meaning of gross income, criticised	31n.
as to treating increase in value of property as income	35
disregarding provision of law that income is not taxable unless received	37
as to taxing income from foreign business and property	44A
disregarding words "actually paid" in the statute	49
as to what companies must make returns	87
extent of power to make	90
as to contents of return	90, 100
as to keeping of book by corporations	101
as to submission of inventory	100
as to appointment of internal revenue agents to collect data	106
powers of,	s
may prescribe form of return	90
but not its substance or contents	90, 100, 134
cannot compel company to disclose how it ar- rives at data given in return	100
whether can compel company to keep books	101
to keep returns in his office	102, 116
to make assessment on the returns	103, 119, 120, 134
ministerial duty of, in making assessments	103, 120, 134
where no return is made	104
in cases of returns imperfect on their face	105
in cases of false or erroneous returns	106 et seq.
to institute proceedings for correction of return	106
quasi-judicial function of	106, 134
delegation of powers by	106
to require additional information from the company	90, 100, 107, 134

[References are to sections]

SECTION

COMMISSIONER OF INTERNAL REVENUE—

Continued

to appoint revenue agent to examine books and take testimony	108
to invoke aid of courts for inspection of books and examination of witnesses	109
to make amended return on information so acquired	112
assessment by, See ASSESSMENT.	
application of general internal revenue statutes as to	129
to authorise institution of action for recovery of taxes	126n.
cannot be both loyal agent and impartial judge	132
mandamus against	134
appeal to, not necessary before suing for illegal distrain	136
necessity for appeal to, before suing to recover back taxes illegally exacted	137
applications to, for refund of taxes	138

COMPANIES. (See also FOREIGN COMPANIES, COR-
PORATIONS.)

what, are liable to this tax	
companies doing no business	9
unincorporated companies	16
companies organized for profit	17
having capital represented by shares	19
insurance companies	20
foreign companies	27, 28
organized or dissolved within the year	29
expressly excepted classes of	21-26
what are deemed "subject to the tax"	72, 73, 87
whether the word includes successors	29n.
returns by,	

See RETURNS.

[References are to sections]

SECTION

COMPANIES — *Continued*.

requiring additional information from 107

right of, to be heard as to correcting return . . . 107, 112

CONGRESS. (See also ACT OF CONGRESS, CONSTITUTIONALITY OF THE ACT OF CONGRESS.)

discussion of corporation tax in 1

designation by, of what tax is on, not conclusive . . . 6

CONSTITUTIONALITY OF THE ACT OF CONGRESS

with respect to income from state and municipal

securities 40, 147

with respect to income from land 41, 141-144

with respect to income from invested personal

property 42, 141-144

on account of failure to provide for notice to

company 107, 112

statute framed to obviate objections to 1, 139

general statement of objections to 140

whether void as unapportioned direct tax

141, 142, 143, 144

objection to, as tax on a state franchise 145

objection to, on the ground of inequality 146

whether impaired by retroactive features of tax . . . 148

effect of partial unconstitutionality 149

CONTEMPT. (See COURTS, BOOKS, WITNESSES.)

CONTRACTS

soliciting of, not necessarily doing business 28

CORPORATION TAX OF 1909. (See also ACT OF CONGRESS LEVYING CORPORATION TAX.)

origin of 1

form of 2

how cited and referred to in this book 2

purpose of 3

what property or rights levied upon 4-14, 48

what corporations, companies or associations are

subject to 15-29

[References are to sections]

	SECTION
CORPORATION TAX OF 1909 — <i>Continued</i>	
companies doing no business	9
unincorporated companies	16
corporations or companies not organized for profit	17
corporations or companies not having capi- tal divided into shares	19
insurance companies	20
expressly excepted classes	21-22
labor organizations	26
agricultural or horticultural organizations	23
fraternal beneficiary societies	24
domestic building and loan associations	25
religious, charitable or educational corpora- tions	26
possible methods of evading	19, 72
what income included in, See INCOME, DEDUCTIONS TO BE MADE FROM GROSS INCOME.	
what is a company "subject to the tax"	72, 73
assessment of, See ASSESSMENT.	
returns for, See RETURN.	
action to recover, See ACTION OF DEBT.	
collection of, See COLLECTION	
CORPORATIONS. (See also COMPANIES.)	
how objects of, determined for purposes of tax law	18
not organized for profit, whether subject to this tax	17
not having capital stock represented by shares	19
expressly excepted classes of	21-26
foreign, when subject to this tax	28
organized or dissolved within the year, whether subject to tax	29

[References are to sections]

SECTION

COSTS

of proceedings for correction of return 111

COURTS

federal, follow state courts as to meaning of doing
business in state statutes 28

jurisdiction of, to compel attendance of witnesses
and production of books for correcting return 109

no direct appeal to, from assessment of tax . . . 132

remedies in,

See REMEDIES.

D

DEBT, ACTION OF. (See ACTION OF DEBT.)

DEBTS. (See also INDEBTEDNESS.)

whether expenses of collecting, deductible from
gross income 47n.

DEDUCTIONS TO BE MADE FROM GROSS INCOME

whether statutory list of, is exhaustive 45, 58, 65, 66, 99A

what proper on general principles 45, 46, 53, 58, 63n., 66

expressly required by the Act of Congress 46-74, 80-84

expenses of maintenance and operation 46-52, 80, 96

See MAINTENANCE AND OPERATION.

for charges such as rentals or franchise payments 52

for losses 53-59, 81

See LOSS.

by insurance companies 58-59

See INSURANCE COMPANIES.

for interest paid on indebtedness . . . 60-65, 67, 82

See also INTEREST, INDEBTEDNESS.

for principal of debts of company paid . . . 66

for additions to sinking funds 66

by banks and trust companies 67, 82

for taxes 68-70, 83

See also TAXES.

[References are to sections]

SECTION

DEDUCTIONS TO BE MADE FROM GROSS	
INCOME — <i>Continued</i>	
for dividends on shares in other companies	71-74, 84
See also DIVIDENDS.	
by foreign companies	79-84
See also FOREIGN COMPANIES.	
return must state amount claimed as	95
DEPOSITS. (See BANKS.)	
with state officers, whether capital within the state	78
DEPRECIATION	
occurring prior to 1909, whether expense of making good may be deducted from gross income	51
deduction for, dependent solely on express statute of investments	53n.
what allowances may be made for	57
occurring in previous years, whether to be allowed for	51, 57
of property of foreign companies	81
amount claimed as, to be stated separately in return	97
DIRECT TAX	
whether an income tax is	141
tax on income from particular business is not whether present tax is within this principle	142
whether tax on income of certain classes of persons is	143
is	144
DISTRRAINT	
for tax in arrear	125
remedies against illegal	136
DIVIDENDS	
this tax not a tax on	13
may be payable though no income received . .	31
on stock held in other companies, whether amount to income	34
whether amount to income from business . .	43

[References are to sections]

SECTION

DIVIDENDS — *Continued*

taxes on right to exist as corporation proportioned to amount of	40
what are	74
on shares held in other companies subject to the tax, deductions from gross income for . . .	71-74
construction of the provision in general . . .	71
on shares in companies whose net income is less than five thousand dollars	72
on shares in foreign companies	73
what are deemed "dividends"	74
on shares held by foreign companies, when to be deducted in ascertaining their taxable income .	84
received on shares in other companies, what return must state in regard to	94

E

EDUCATIONAL CORPORATIONS

what are	26
exempt from this tax	26

EVASION

of the tax, possible modes of	19, 72
---	--------

EXEMPTIONS FROM TAXATION

what included in	40, 43
----------------------------	--------

F

FOREIGN BUSINESS AND PROPERTY

income of domestic company from, whether taxable	44A
--	-----

FOREIGN COMPANIES

not doing business, not liable to this tax . . .	9
what are	27
what deemed to be engaged in business in the United States	28

[References are to sections]

SECTION

FOREIGN COMPANIES — *Continued*

ceasing to do business in United States prior to passage of act	29
income of, not taxable because stock owned by domestic company	34
dividends on shares in, when deductible from gross income of domestic companies	73
how taxable income of, calculated	75-84
what is income from American business of	76, 77
what is income of, from capital invested in United States	78
deductions by, from gross income	79-84
expenses of, for maintenance and operation	80
losses by, when deductible from gross income	81
interest on indebtedness of, when deductible from gross income	82
taxes paid by, when may be deducted from gross income	83
dividends on shares held by, in other companies	84
what returns by, should state in regard to maintenance and operation	96
in regard to losses	97
in regard to indebtedness and interest	92, 98
returns by, in general,	

See RETURNS.

FRANCHISE

so-called tax on, as tax on business	4, 11
to be a corporation, this tax not on	11, 145
taxes on, proportioned to amount of dividends	40
taxes on, proportioned to income	40n.
whether tax on, is a tax on property	11n.
whether this tax unconstitutional as a tax on a, granted by state	145

FRANCHISE PAYMENTS

deductions for, from gross income	52
---	----

[References are to sections]

SECTION

G

GOODWILL

tax on	5
------------------	---

I

IMPROVEMENTS

whether expenses of, deductible from gross income	47
---	----

INCOME (See also INCOME TAX.)

this tax proportioned to	10
whether a mere measure of the value of the business	7-10, 14
how calculated for purposes of this tax	30-84A
definition of	33
distinguished from profits	31
increase in value of assets not taxable as	31, 35
cannot be calculated by balance-sheet method of estimating profits available for dividends	31
gross,	
whether equivalent to gross profits	31
what is, in general	33
statutory provisions as to method of calculating, mandatory	32
rental value of property occupied by company not	33
money described as capital in remittance to company, may be	33
dividends on stock of other companies as	34
of other companies in which taxpaying company owns shares, whether taxable	34
what is, in case of sale of property by company	35, 36
received, what is	37
as trustee, whether taxable	38
received before passage of act, whether taxable	39
derived from property exempt from taxation, whether taxable	40

[References are to sections]

SECTION

INCOME—*Continued*

taxes on right to exist as a corporation proportioned to	40n.
from contracts with state, whether taxable . . .	40
from land	41
from invested personal property	42
from business as distinguished from investments, what is	43
from <i>ultra vires</i> business	44
from foreign business and property	44A
deductions from gross, in order to ascertain net, See DEDUCTIONS TO BE MADE FROM GROSS INCOME.	
“paid out of” when expenses deemed to be . . .	49n., 50
of insurance companies, how estimated	58, 59
of foreign companies, how calculated for purposes of tax	75-84
See FOREIGN COMPANIES.	
for what period calculated for purposes of tax . .	84A
net, to be stated in return	99A

INCOME TAX

corporation tax as substitute for	1, 139
whether this tax amounts to	4-10, 14
difference between this tax and an	14
whether constitutional	40, 41, 42, 141

INDEBTEDNESS

bonded, or other, what is	60
interest paid on, deduction for, from gross income	60-65, 67, 82

See also INTEREST.

limitation of amount of, on which interest paid may be deducted from gross income	61, 62, 63, 82
of non-stock corporations	64
in excess of paid-up capital stock outstanding, what is	61-64
payment of principal of, deductions for, from gross income	66

[References are to sections]

SECTION

INDEBTEDNESS — *Continued*

- of foreign companies, deductions on account of . . . 82
- what return must state in regard to . . . 92, 98

INEQUALITY

- in the operation of this tax . . . 8, 38, 71, 72, 146

INHERITANCE TAX

- not a tax on the property inherited . . . 4n.
- proportioned to value of exempt property . . . 40

INJUNCTION

- against illegal tax . . . 133
- against giving information unnecessarily . . . 133

INSURANCE

- whether premiums paid for, are deductible from
 - gross income . . . 47
- when premiums for, deemed actually paid . . . 49
- losses not compensated by . . . 56

INSURANCE COMPANIES

- effect of making all, subject to this tax . . . 20
- what are . . . 20
- when deemed to be doing business in a state . . . 28
- losses by, what to be deducted from gross income . . . 58
- deductions by, from gross income, for amounts
 - other than dividends paid on policy or annuity
 - contracts . . . 58
 - for additions to reserve funds . . . 59
- how income of, to be estimated . . . 58, 59
- whether deduction may be made for unearned
 - premiums . . . 58
- mutual, interest on indebtedness of . . . 64
 - returns by, need not state amount of capital
 - stock . . . 91
- bonds deposited by, with state officer as capital
 - within the state . . . 78
- foreign, deductions allowed by, from gross income . . . 81
- special allowances claimed by, to be stated separately in the return . . . 97

[References are to sections]

SECTION

INSPECTION

- of books. (See BOOKS.)
- of returns 116

INTEREST. (See also INDEBTEDNESS.)

- on bonded or other indebtedness, when to be deducted from gross income . . . 60-65, 67, 82
- on indebtedness in excess of paid-up capital stock . . . 65
- on indebtedness of non-stock corporations . . . 64
- on indebtedness of foreign companies . . . 82
- on amount of assessment 123
- recoverable in actions to recover back illegal tax 137

INTERNAL REVENUE LAWS

- application of, to returns 118
 - to collection of the tax 125
 - to assessment of the tax 125, 129, 130
 - to the corporation tax in general 127
- as to the powers of Secretary of the Treasury . . . 128
- as to the powers of Commissioner of Internal Revenue 129
- as to collectors 130
- applicability of, to remedies against illegal assessment 132

INVENTORY

- whether company compellable to submit 100

INVESTMENTS

- income from, whether included in the tax . . . 10, 42
- acquisition of property as, not doing business . . . 28
- what is income from, as distinguished from income from business 43
- within United States, what is income from . . . 78

L

LAND

- income from, whether taxable 41

LEGACY TAX. (See INHERITANCE TAX.)

[References are to sections]

SECTION

LIMITATIONS

for supplying or correcting return	113
as bar to action to recover tax	122, 126
against suit to recover back taxes paid under protest	137
against appeal to Commissioner of Internal Revenue for refund	137, 138

LOSS

income charges borne by capital as	50
whether damages paid for torts are a	47
whether proper to allow for, without express provision	53
by payment of bonds purchased at premium	53n.
by depreciation of investments	53n., 57, 81
See also DEPRECIATION.	
by embezzlement	53n., 54
of circulating capital	53
meaning of	54
by insolvency of debtors	54
must be sustained within the year	55
must be not compensated by insurance or otherwise	56
by foreign companies, when deductible from gross income	81
what returns must state in regard to	97
burden of proving	126

M

MAINTENANCE AND OPERATION

expenses of, to be deducted from gross income	46
what are expenses of, in general	47
during previous years, whether deductible	47, 96
of property as distinguished from business	48, 80, 96
expenses of, must be actually paid in order to be deducted	49
when expenses deemed to be paid "out of in- come"	49n., 50

[References are to sections]

SECTION

MAINTENANCE AND OPERATION — *Continued*

what are "ordinary and necessary expenses of"	51
payments in nature of rentals or franchise payments	52
payment of losses as part of expenses of	58
payment of indebtedness as part of expense of	60, 66
contributions to sinking fund as expense of	66
whether expenses of, include ordinary taxes imposed by foreign government	70
of foreign companies, what expenses deductible as	80
what return must state in regard to	96

MANDAMUS

as remedy against illegal proceedings in connection with tax	134
--	-----

MUNICIPAL SECURITIES

whether income derived from, is taxable	40
---	----

N

NAME

not conclusive as to nature of tax	6
------------------------------------	---

NOTICE

of proceedings to supply or correct return, whether necessary	107, 112
of assessment	123, 130

O

OATH

to return, who shall make	88
by whom to be administered	88, 130
form of	88

OBJECTS

of corporations or companies, how determined	18
subject to tax, none under this law	130

OPERATION. (See MAINTENANCE AND OPERATION.)

ORIGIN

of the corporation tax of 1909	1
--------------------------------	---

[References are to sections]

SECTION

P

PAYMENT

of the tax, when to be made	123
penalties for failure to make	123
to whom to be made	123
under protest	124, 137
enforcement of,	

See COLLECTION.

PERSONAL PROPERTY

invested, whether income from, is taxable	42
---	----

PHILIPPINE ISLANDS

whether corporation organized under laws of, are subject to this tax	27
---	----

PORTO RICO

whether corporations organized under laws of, are subject to this tax	27
--	----

PREMIUM. (See INSURANCE.)

paid for lease, whether deductible from gross income	52n.
---	------

PRESIDENT

may authorize disclosure of company's secrets	117
---	-----

PROFITS. (See also INCOME.)

burden of proving	126
-----------------------------	-----

PROPERTY. (See also LAND, PERSONAL PROPERTY,
INCOME.)

when taxes proportioned to value of, not taxes on	4
ownership or acquisition of, in state, not doing business	28
increase in value of, not income	31, 35
sales of, what amounts to income in cases of	35, 36
expense of maintaining	48, 80, 96

See MAINTENANCE AND OPERATION.

depreciation of,

See DEPRECIATION.

sale of, for non-payment of tax	125
---	-----

[References are to sections]

SECTION

PUBLICITY

of returns	116
provision to guard against	117

R

RAILWAYS

when not doing business in state	28
exemptions of, from taxation	43

REGULATIONS. (See COMMISSIONER OF INTERNAL
REVENUE, SECRETARY OF THE TREASURY.)

RELIGIOUS CORPORATIONS

what are	26
exempt from this tax	26

REMEDIES

for collection of tax,

See COLLECTION.

against illegal tax or assessment	132-138
by injunction	133
by mandamus, etc.	134
by passive resistance	135
by trover or trespass in case of illegal distraint	136
by action to recover back taxes paid under	
protest	137
by application to Commissioner of Internal	
Revenue	138

RENTAL VALUE

of premises occupied by company, whether part	
of gross income	33
of part of banking house occupied by manager,	
whether deductible from gross income	47

RENTALS

deductions for payments such as	52
---	----

RESERVE FUNDS. (See also SINKING FUND.)

additions to, whether deductible from gross income	59
--	----

RETURN

importance of	85
-------------------------	----

[References are to sections]

	SECTION
RETURN — <i>Continued</i>	
when to be made	86
by what companies to be made	87
by whom and how to be sworn to	88
to whom to be made	89
control of Commissioner of Internal Revenue	
over	90
what it must contain	91-101
statement as to capital stock	91
amount of indebtedness	92
gross income	93
dividends received from companies subject	
to tax	94
statement as to maintenance and operation	96
as to losses and depreciation	97
as to interest paid	98
as to taxes	99
net income	99A
may contain additional statements	100
duty of company where cannot state details of,	
accurately	101
guessing at data stated in	101
disposition of	102, 116
assessment to be made on facts as stated in	
	103, 119, 120, 134
failure to make, consequences of	104, 121
imperfect on its face, effect of	105
correcting an erroneous return	106-114
necessity for evidence of its incorrectness	
before instituting proceeding for cor-	
rection	106, 110, 134
preliminary proceeding before Commissioner	106
requiring additional information from the	
company	107
examining books and taking testimony	
	108, 109, 110, 111

[References are to sections]

SECTION

RETURN — *Continued*

action of Commissioner on information so acquired	112
limitation as to time	113
penalty for erroneous	115, 121
as public record	116
not affected by other internal revenue laws	118
distinction between honestly erroneous and fraudulent returns	115, 121
assessment on, See ASSESSMENT.	
general statutes as to	130
REVENUE AGENTS	
specially designated to examine books and take testimony	106, 108

S**SALARIES**

money paid in commutation of, whether deduc- tible from gross income	47
---	----

SALE

of assets by corporation, what is income in cases of	35, 36
for non-payment of tax	125

SEARCHES

by collectors, not authorized with respect to this tax	130
---	-----

SECRETARY OF THE TREASURY

validity of regulations of	90n., 128
no power to add to statutory requirements as to contents of return	100
powers of, in general	128

SHAREHOLDER

suit by to enjoin company from paying illegal tax	133
to enjoin company from giving unnecessary information to collectors	133

[References are to sections]

	SECTION
SHARES	
stock not divided into	19
whether this tax is on privilege of having . . .	12
taxes on, proportioned to value of exempt prop- erty owned by corporation	40
issued at a discount, whether to be included in estimating amount of capital stock outstanding	61
watered	61
outstanding, what are	63
whether taxes on, may be deducted from gross income of company	68
SINKING FUNDS. (See also RESERVE FUNDS.)	
money added to, whether deductible from gross income	66
SPECIAL ASSESSMENTS	
whether deductible from gross income as taxes .	69
STATE SECURITIES	
whether income derived from is taxable	40
STATUTES. (See TABLE OF FEDERAL STATUTES CITED.)	
STOCK. (See CAPITAL STOCK, SHARES.)	
SUBPOENA DUCES TECUM	
from state court, disobedience of, by collectors .	128n.
to compel production of documents for correction of return	108, 109
T	
TARIFF	
corporation tax as amendment to tariff Act .	1, 2, 139
TAX. (See CORPORATION TAX, ACT OF CONGRESS LEVYING CORPORATION TAX, SHARES.)	
how to determine what property or rights tax is on	4, 6
remedies against illegal, See REMEDIES.	
direct, what is	141, 142, 143, 144
TAXES	
when to be deducted from gross income . . .	68-70

[References are to sections]

SECTION

TAXES — *Continued*

must be paid within the year	68
whether must be assessed against the company	68
assessed against company as trustee . . .	68
special assessments for betterments . . .	69
imposed by foreign governments	70
in case of foreign companies	83
what returns must state in regard to . . .	99

TESTIMONY

on preliminary proceeding before Commissioner to show falsity of return	106
of officers and employees of the company, to correct return	108

TIME

for making return	86
for correcting return	113
for supplying return	113
for assessment	122
for notice of assessment	123
for suit to recover back taxes paid under protest .	137
for appealing to Commissioner of Internal Revenue for refund of taxes	137, 138

TITLE

of act levying corporation tax	3
how far to be considered in construction of statute	3

TORTS

whether damages paid for, are deductible from gross income	47
---	----

TRUSTEE

income received as, whether taxable	38
taxes paid by company as, whether deductible from gross income	68

U**ULTRA VIRES BUSINESS**

whether income from, taxable	44
--	----

[References are to sections]

SECTION

UNIFORMITY. (See also INEQUALITY.)

whether this tax violates constitutional require-
ment of 146

UNINCORPORATED COMPANIES

whether liable to this tax 16

UNITED STATES

action against, to recover back taxes paid under
protest 137

to recover amount ordered refunded by Com-
missioner of Internal Revenue 138

meaning of 27

W

WITNESSES

at preliminary proceeding before Commissioner to
show incorrectness in return 106

who may be, on proceedings for correction of
return 108

compelling attendance of 109, 110, 111

WORDS AND PHRASES EXPLAINED OR COM-
MENTED UPON

actually paid 49, 60, 67

agricultural or horticultural associations 23

annually 84A

applicable 127

articles or objects subject to tax 130

ascertained as provided in the foregoing para-
graphs 45

assessments thereon 103, 132

associations 16, 29n.

at any time within three years 113

bearing upon matters required to be included in
the return 108

bonded or other indebtedness 60

building and loan associations 25

business 4, 21, 76

[References are to sections]

SECTION

WORDS AND PHRASES — *Continued*

business conducted	81
business transacted within the United States	76
capital and surplus	43n.
capital invested	10, 78
capital stock	61
capital stock represented by shares	19
charges such as rentals or franchise payments	52, 70
close of the year	62, 84An.
collection, remission and refund of internal revenue	
taxes	127
companies	16, 29n.
compensated by insurance or otherwise	56
corporation, joint stock company or association	16n.
corporations	16n.
domestic	25
due	123
during such year	84A
earnings	31n., 33, 50.
encourage the industries of the United States	3
engaged in business in the United States	28
equivalent to	6
evidence	106
exercises a trade	28
extended and made applicable	127
false or fraudulent	115, 121
foreign country	27
form	90
franchise	4, 11
franchise payments	52
fraternal beneficiary societies	24
from all sources	5, 10, 42, 44A, 93
gross income	31n., 76, 93
income	31, 50
insurance	56, 58
insurance companies	20, 58

[References are to sections]

SECTION

WORDS AND PHRASES — *Continued*

interest of money	43n.
labor organizations	22
loss	47, 50, 54
maintenance and operation	47
may	107
necessary expenses	51
net income	45
not compensated by insurance or otherwise	56
now or hereafter organized	29
objects liable to tax	130
officers and employees	108
operation	47
ordinary and necessary expenses	51
organized and operated	18
organized for profit	17, 20, 26
other officer or employee of the United States	117
otherwise	56
out of earnings	49n., 50, 80
out of income	50
outstanding	63
paid	49, 60, 67
paid-up capital stock	61
person	130n.
principal place of business	89
profit	17
profits	17n., 20n., 30
properties	48
property	48, 96
received	37, 76
religious, charitable or educational purposes	26
remission and refund	127
rentals or franchise payments	52
required by law	59
so far as applicable to and not inconsistent with	127
subject to the tax hereby imposed	72, 73, 87

[References are to sections]

SECTION

WORDS AND PHRASES — *Continued*

sustained within the year	55
taxes	68, 69
territories	27
true and accurate return	101
United States and its territories	27
upon the information so acquired	112
with intent to defeat or avoid the assessment	115, 121
with respect to the carrying on or doing business	5, 6, 38, 48, 149
within the year	84A, 96
year	55, 84A

Y

YEAR

for which tax is assessed	84A
-------------------------------------	-----

